TECHNICAL CORRECTIONS ACT OF 1983

HEARING

BEFORE THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

NINETY-EIGHTH CONGRESS

FIRST SESSION

ON

H.R. 3805

A BILL TO MAKE TECHNICAL CORRECTIONS IN CERTAIN RECENT LEGISLATION DEALING WITH THE TAX AND SOCIAL SECURITY LAWS

SEPTEMBER 22, 1983

Serial 98-36

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TECHNICAL CORRECTIONS ACT OF 1983

THURSDAY, SEPTEMBER 22, 1983

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The committee met at 9:40 a.m., pursuant to notice, in room 1100, Longworth House Office Building, Hon. Barbara B. Kennelly presiding.

[The press release announcing the hearing and a copy of the bill, H.R. 3805 follow:]

[Press release of Friday, September 9, 1983]

HON. DAN ROSTENKOWSKI (D., ILL.), CHAIRMAN, COMMITTEE ON WAYS AND MEANS, ANNOUNCES HEARINGS ON H.R. 3805, THE TECHNICAL CORRECTIONS ACT OF 1983

The Honorable Dan Rostenkowski (D., Ill.), chairman of the Committee on Ways and Means, U.S. House of Representatives, today announced that the Committee will hold a public hearing on H.R. 3805, The Technical Corrections Act of 1983. The hearing will be held on Thursday, September 22, 1983, beginning at 9:30 a.m. in the Committee's main hearing room, 1100 Longworth House Office Building.

H.R. 3805 would make technical corrections to the Tax Equity and Fiscal Responsibility Act of 1982 (P.L. 97-248), the Subchapter S Revision act of 1982 (P.L. 97-354), the Highway Revenue act of 1982 (P.L. 97-424), the Social Security Act Amendments of 1983 (P.L. 98-21), and related legislation.

In announcing this hearing, Chairman Rostenkowski expressed his appreciation for the cooperation of the Treasury Department, the Social Security Administration and the Health Care Financing Administration, in preparing this legislation, and the helpful comments received from the American Bar Association, the American Institute of Certified Public Accountants, and other professional groups and individuals.

The Committee invites testimony from the public on the provisions of H.R. 3805 or other technical amendments to the legislation affected by the bill. However, the Committee wishes to emphasize that the scope of this hearing will be strictly limited to technical amendments, and that the Committee will not receive testimony which proposes substantive or unrelated policy changes.

DETAILS FOR SUBMISSION OF REQUESTS TO BE HEARD

Individuals and organizations interested in presenting oral testimony before the Committee must submit their requests to be heard by telephone to Harriett Lawler [(202) 225-3627] no later than close of business, Monday, September 19, 1983, to be followed by a formal written request to John J. Salmon, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. Notification to those scheduled to appear will be made by telephone as soon as possible after the filing deadline.

It is urged that persons and organizations having a common position make every effort to designate one spokesman to represent them in order for the Subcommittee to hear as many points of view as possible. Time for oral presentations will be strictly limited with the understanding that a more detailed statement may be included in the printed record of the hearing. This process will afford more time for members to question witnesses. In addition, witnesses may be grouped as panelists with strict time limitations for each panelist.

In order to assure the most productive use of the limited amount of time available to question hearing witnesses, witnesses scheduled to appear before the Committee are required to submit 200 copies of their prepared statements to the full Committee office, room 1102 Longworth House Office Building, at least 24 hours in advance of their scheduled appearance. Failure to comply with this requirement may result in the witness being denied the opportunity to testify in person.

Each statement to be presented to the Committee or any written statement submitted for the printed record must contain the following information:

1. The name, full address, and capacity in which the witness will appear as well as a telephone number where he or his designated representative may be reached;
2. A list of any clients or persons, or any organization for whom witness appears; and
3. A topical outline or summary of comments and recommendations.

WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE

Persons submitting a written statement in lieu of a personal appearance should submit at leat six (6) copies of their statement by the close of business, Wednesday, September 28, 1983, to John J. Salmon, Chief counsel, Committee on Ways and Means, U.S. House of Representatives, Washington, D.C. 20515. If those filing written statements for the record of the printed hearing wish to have their statements distributed to the press and the interested public, they may submit additional copies for this purpose if provided to the full Committee office before the hearing begins.

I

98TH CONGRESS
1ST SESSION

H. R. 3805

To make technical corrections in certain recent legislation dealing with the tax and social security laws.

IN THE HOUSE OF REPRESENTATIVES

AUGUST 4, 1983

Mr. ROSTENKOWSKI introduced the following bill; which was referred to the Committee on Ways and Means

---

A BILL

To make technical corrections in certain recent legislation dealing with the tax and social security laws.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SEC. 1. SHORT TITLE; AMENDMENT OF 1954 CODE.

(a) SHORT TITLE.—This Act may be cited as the "Technical Corrections Act of 1983".

(b) AMENDMENT OF 1954 CODE.—Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered

to be made to a section or other provision of the Internal Revenue Code of 1954.

TITLE I—AMENDMENTS RELATED TO TAX EQUITY AND FISCAL RESPONSIBILITY ACT OF 1982

SEC. 101. TECHNICAL CORRECTIONS OF PROVISIONS RELATING TO INDIVIDUALS.

(a) AMENDMENTS RELATED TO SECTION 201.—

(1) DEFINITION OF REGULAR TAX.—Paragraph (2) of section 55(f) (defining regular tax) is amended by striking out "sections 72(m)(5)(B)" and inserting in lieu thereof "sections 47(a), 72(m)(5)(B)".

(2) SPECIAL ELECTION FOR INTANGIBLE DRILLING AND DEVELOPMENT COSTS LIMITED TO WELLS LOCATED IN THE UNITED STATES.—Subparagraph (A) of section 58(i)(4) (relating to special election for intangible drilling and development cost not allocable to interest as limited partner) is amended by inserting "(with respect to wells located in the United States)" after "intangible drilling costs".

(b) AMENDMENT RELATED TO SECTION 202.—Paragraph (5) of section 213(d) (relating to definitions) is amended by striking out "paragraph (2)" and inserting in lieu thereof "paragraph (4)".

(c) AMENDMENTS RELATED TO SECTION 203.—

(1) COORDINATION OF SECTION 165(h) WITH SECTION 1231.—Paragraph (2) of section 165(h) (relating to casualty and theft losses) is amended by adding at the end thereof the following new subparagraph:

"(C) COORDINATION WITH SECTION 1231.—

"(i) For purposes of paragraph (1)(B), adjusted gross income shall be determined without regard to the application of section 1231 to any gain or loss from an involuntary conversion of property described in subsection (c)(3) arising from fire, storm, shipwreck, or other casualty or from theft.

"(ii) Section 1231 shall be applied after the application of paragraph (1)."

(2) CLERICAL AMENDMENT.—Subsection (d) of section 6405 (relating to refunds attributable to certain disaster losses) is amended by striking out "section 165(h)" and inserting in lieu thereof "section 165(i)".

SEC. 102. TECHNICAL CORRECTIONS OF PROVISIONS PRIMARILY RELATING TO BUSINESSES.

(a) AMENDMENTS RELATED TO SECTION 204.—

(1) CLARIFICATION OF ADDITIONAL AMOUNT TREATED AS ORDINARY INCOME UNDER SECTION

1250.—Paragraph (1) of section 291(a) (relating to section 1250 capital gain treatment) is amended—

(A) by striking out "under section 1250" in subparagraph (B) and inserting in lieu thereof "under section 1250 (determined without regard to this paragraph)", and

(B) by striking out "which is ordinary income" and inserting in lieu thereof "which is ordinary income under section 1250".

(2) INVESTMENT TAX CREDIT ALLOWED ONLY FOR MINERAL EXPLORATION AND DEVELOPMENT COSTS FOR DEPOSITS LOCATED IN THE UNITED STATES.—Clause (ii) of section 291(b)(2)(B) is amended by inserting "in the case of a deposit located in the United States," after "(ii)".

(3) CLARIFICATION OF COORDINATION WITH COST DEPLETION.—Paragraph (6) of section 291(b) (relating to coordination with cost depletion) is amended to read as follows:

(6) COORDINATION WITH COST DEPLETION.—The portion of the adjusted basis of any property which is attributable to amounts to which paragraph (1) applied shall not be taken into account for purposes of determining depletion under section 611."

(4) CLARIFICATION OF DEFINITION OF INTEREST.—Subparagraph (B) of section 291(e)(1) (relating to interest on debt to carry tax-exempt obligations acquired after December 31, 1982) is amended by adding at the end thereof the following new clause:

"(iii) INTEREST.—For purposes of this subparagraph, the term 'interest' includes amounts (whether or not designated as interest) paid in respect of deposits, investment certificates, or withdrawable or repurchasable shares."

(b) AMENDMENT RELATED TO SECTION 205.—Subsection (q) of section 48 (relating to basis adjustment to section 38 property) is amended by adding at the end thereof the following new paragraph:

"(6) ADJUSTMENT IN BASIS OF INTEREST IN PARTNERSHIP OR S CORPORATION.—The adjusted basis of—

"(A) a partner's interest in a partnership, and

"(B) stock in an S corporation,

shall be appropriately adjusted to take into account adjustments made under this subsection in the basis of property held by the partnership or S corporation (as the case may be)."

(c) AMENDMENT RELATED TO SECTION 207.—Paragraph (4) of section 189(e) (defining residential real property) is amended by striking out "or" at the end of subparagraph (A), by striking out the period at the end of subparagraph (B) and inserting in lieu thereof ", or", and by adding at the end thereof the following new subparagraph:

"(C) real property held by a cooperative housing corporation (as defined in section 216(b)) and used for dwelling purposes."

(d) AMENDMENT RELATED TO SECTION 212.—Paragraph (1) of section 954(h) (defining foreign base company oil-related income) is amended by striking out "section 907(c)(2)" and inserting in lieu thereof "section 907(c)".

(e) AMENDMENTS RELATED TO SECTION 222.—

(1) Sections 301(e)(2) and 302(f)(3) are each amended by striking out "partial or complete liquidation" and inserting in lieu thereof "complete liquidation".

(2) Paragraph (1) of section 543(a) (defining personal holding company income) is amended by striking out subparagraph (C), by adding "and" at the end of subparagraph (A), and by striking out ", and" at the end of subparagraph (B) and inserting in lieu thereof a period.

(f) AMENDMENT RELATED TO SECTION 223.—Paragraph (1) of section 311(e) (defining qualified stock) is amended by adding at the end thereof the following new subparagraph:

"(C) RULES FOR PASSTHRU ENTITIES.—In the case of an S corporation, partnership, trust, or estate—

"(i) the determination of whether subparagraph (A) is satisfied shall be made at the shareholder, partner, or beneficiary level (rather than at the entity level), and

"(ii) the distribution shall be treated as made directly to the shareholders, partners, or beneficiaries in proportion to their respective interests in the entity."

(g) AMENDMENTS RELATED TO SECTION 224.—

(1) DEFINITION OF PURCHASE.—

(A) Subparagraph (B) of section 338(h)(3) (defining purchase) is amended to read as follows:

"(B) DEEMED PURCHASE UNDER SUBSECTION (a).—The term 'purchase' includes any deemed purchase under subsection (a)(2)."

(B) Paragraph (3) of section 338(h) is amended by adding at the end thereof the following new subparagraph:

"(C) CERTAIN STOCK ACQUISITIONS FROM RELATED CORPORATIONS.—

"(i) IN GENERAL.—Clause (iii) of subparagraph (A) shall not apply to an acquisition of stock from a related corporation if at least 50 percent in value of the stock of such related corporation was acquired by purchase (within the meaning of subparagraphs (A) and (B)).

"(ii) CERTAIN DISTRIBUTIONS.—Clause (i) of subparagraph (A) shall not apply to an acquisition of stock described in clause (i) of this subparagraph if the corporation acquiring such stock—

"(I) made a qualified stock purchase of stock of the related corporation, and

"(II) made an election under this section (or is treated under subsection (e) as having made such an election) with respect to such qualified stock purchase.

"(iii) RELATED CORPORATION DEFINED.—For purposes of this subparagraph, a corporation is a related corporation if stock

owned by such corporation is treated (under section 318(a) other than paragraph (4) thereof) as owned by the corporation acquiring the stock."

(C) Paragraph (1) of section 338(h) (defining 12-month acquisition period) is amended by inserting before the period at the end thereof the following: "(or, if any of such stock was acquired in an acquisition which is a purchase by reason of subparagraph (C) of paragraph (3), the date on which the acquiring corporation is first considered under section 318(a) (other than paragraph (4) thereof) as owning stock owned by the corporation from which such acquisition was made)".

(D) Paragraph (4) of section 318(b) (relating to cross references) is amended to read as follows: "(4) section 338(h)(3) (defining purchase);".

(2) SPECIAL RULES FOR APPLYING SECTION 338.—

(A) Subsection (h) of section 338 (relating to definitions and special rules) is amended by striking out paragraph (7), by redesignating paragraphs (8) and (9) as paragraphs (9) and (10), respectively, and by inserting after paragraph (6) the following new paragraphs:

"(7) ADDITIONAL PERCENTAGE MUST BE ATTRIBUTABLE TO PURCHASE.—For purposes of subsection (c)(1), any increase in the maximum percentage of stock taken into account over the percentage taken into account under subsection (b)(2) shall be taken into account only to the extent such increase is attributable to purchase or to a redemption by the target corporation to which section 302(a) applies.

"(8) ACQUISITION BY AFFILIATED CORPORATIONS TAKEN INTO ACCOUNT FOR CONSISTENCY PURPOSES.—For purposes of subsections (e) and (f), except as otherwise provided in regulations, an affiliated group shall be treated as 1 corporation."

(B) Paragraph (9) of section 338(h), as redesignated by subparagraph (A), is amended by striking out "paragraph (9)" and inserting in lieu thereof "paragraph (10)".

(C) Subsection (h) of section 338 is amended by adding at the end thereof the following new paragraph:

"(11) SECTION 337 TO APPLY WHERE TARGET HAD ADOPTED PLAN FOR COMPLETE LIQUIDATION.—If—

"(A) during the 12-month period ending on the acquisition date the target corporation adopted a plan of complete liquidation,

"(B) such plan was not rescinded before the close of the acquisition date, and

"(C) the purchasing corporation makes an election under this section (or is treated under subsection (e) as having made such an election) with respect to the target corporation,

then, subject to rules similar to the rules of subsection (c)(1), for purposes of section 337 (and other provisions which relate to section 337), the target corporation shall be treated as having distributed all of its assets as of the close of the acquisition date."

(3) COORDINATION WITH SECTION 333.—The last sentence of paragraph (1) of section 338(c) (relating to coordination with section 337 where purchasing corporation holds less than 100 percent of stock) is amended by striking out "such 1 year period" and inserting in lieu thereof "such 1 year period and section 333 does not apply to such liquidation".

(4) TREATMENT OF CERTAIN LIQUIDATIONS.—

(A) IN GENERAL.—Section 269 (relating to acquisitions made to evade or avoid income tax) is amended by redesignating subsection (b) as sub-

section (c) and by inserting after subsection (a) the following new subsection:

"(b) CERTAIN LIQUIDATIONS AFTER QUALIFIED STOCK PURCHASES.—

"(1) IN GENERAL.—If—

"(A) there is a qualified stock purchase by a corporation of another corporation,

"(B) an election is not made under section 338 with respect to such purchase,

"(C) the acquired corporation is liquidated pursuant to a plan of liquidation adopted not more than 2 years after the acquisition date, and

"(D) the principal purpose for such liquidation is the evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit, or other allowance which the acquiring corporation would not otherwise enjoy,

then the Secretary may disallow such deduction, credit, or other allowance.

"(2) MEANING OF TERMS.—For purposes of paragraph (1), the terms 'qualified stock purchase' and 'acquisition date' have the same respective meanings as when used in section 338."

(B) CONFORMING AMENDMENT.—Subsection (c) of section 269 (as redesignated by subpara-

graph (A)) is amended by striking out "subsection (a)" and inserting in lieu thereof "subsection (a) or (b)".

(5) ASSETS TREATED AS SOLD AT FAIR MARKET VALUE.—

(A) Paragraph (1) of section 338(a) (relating to general rule) is amended by inserting "at fair market value" after "the acquisition date".

(B) Subsection (b) of section 338 (relating to price at which deemed sale made) is amended to read as follows:

"(b) BASIS OF ASSETS AFTER DEEMED PURCHASE.—

"(1) IN GENERAL.—For purposes of subsection (a), the assets of the target corporation shall be treated as purchased at an amount equal to their adjusted fair market value.

"(2) ADJUSTED FAIR MARKET VALUE.—For purposes of paragraph (1), the term 'adjusted fair market value' means the excess (if any) of—

"(A) the aggregate fair market value of the assets of the target corporation as of the close of the acquisition date, over

"(B) the amount of the net unrealized appreciation determined under paragraph (3).

"(3) AMOUNT OF NET UNREALIZED APPRECIATION.—For purposes of paragraph (2), the amount of the net unrealized appreciation determined under this paragraph is the excess (if any) of—

"(A) the fair market value of stock of the target corporation which is held by the purchasing corporation on the acqusition date, over

"(B) the aggregate bases of stock described in subparagraph (A).

"(4) ALLOCATION AMONG ASSETS.—The amount determined under paragraph (1) shall be allocated among the assets of the target corporation under regulations prescribed by the Secretary."

(6) TIME FOR MAKING ELECTION.—Paragraph (1) of section 338(g) (relating to election) is amended to read as follows:

"(1) WHEN MADE.—Except as otherwise provided in regulations, an election under this section shall be made not later than the 15th day of the 9th month beginning after the month in which the acquisition date occurs."

(h) AMENDMENTS RELATED TO SECTION 226.—

(1) AMOUNT CONSTITUTING DIVIDEND.—Subparagraph (A) of section 304(b)(2) (relating to amount constituting dividend) is amended to read as follows:

"(A) WHERE SUBSECTION (a)(1) APPLIES.—In the case of any acquisition of stock to which paragraph (1) (and not paragraph (2)) of subsection (a) applies, the determination of the amount which is a dividend shall be made as if the property were distributed—

"(i) by the acquiring corporation to the extent of its earnings and profits, and

"(ii) then by the issuing corporation."

(2) Coordination with section 351.—Subparagraph (A) of section 304(b)(3) (relating to coordination with section 351) is amended by striking out "(and not part III)" and inserting in lieu thereof "(and not section 351 and not so much of sections 357 and 358 as relates to section 351)".

(3) CERTAIN ASSUMPTIONS OF LIABILITY.—The first sentence of clause (i) of section 304(b)(3)(B) (relating to certain assumptions of liability, etc.) is amended—

(A) by striking out "Subsection (a)" and inserting in lieu thereof "Subparagraph (A)", and

(B) by inserting before the period "from a person none of whose stock is attributable to the

transferor under section 318(a) (other than paragraph (4) thereof)".

(4) DISTRIBUTIONS INCIDENT TO FORMATION OF BANK HOLDING COMPANIES.—Subparagraph (C) of section 304(b)(3) (relating to distributions incident to formation of bank holding companies) is amended by adding at the end thereof the following new sentence: "For purposes of this subparagraph, any assumption of (or acquisition of stock subject to) a liability under subparagraph (B) shall not be treated as a distribution of property."

(5) CONSTRUCTIVE OWNERSHIP.—

(A) Paragraph (3) of section 304(c) (relating to constructive ownership) is amended by striking out the last sentence and inserting in lieu thereof the following: "For purposes of the preceding sentence, sections 318(a)(2)(C) and 318(a)(3)(C) shall be applied by substituting '5 percent' for '50 percent'."

(B) Paragraph (4) of section 306(c) is amended by striking out the last sentence and inserting in lieu thereof the following: "For purposes of applying the preceding sentence to paragraph (3), sections 318(a)(2)(C) and 318(a)(3)(C) shall be applied by substituting '5 percent' for '50 percent'."

(6) CERTAIN STOCK ACQUIRED IN SECTION 351 EXCHANGE.—Paragraph (3) of section 306(c) (relating to certain stock acquired in section 351 exchange) is amended by striking out the last sentence and inserting in lieu thereof the following: "Rules similar to the rules of section 304(b)(2) shall apply—

"(A) for purposes of the preceding sentence, and

"(B) for purposes of determining the application of this section to any subsequent disposition of stock which is section 306 stock by reason of an exchange described in the preceding sentence."

(i) AMENDMENT RELATED TO SECTION 229.—Subsection (c) of section 229 of the Tax Equity and Fiscal Responsibility Act of 1982 (relating to modification of regulations on the completed contract method of accounting) is amended by adding at the end thereof the following new paragraph:

"(4) UNDERPAYMENTS OF ESTIMATED TAX FOR 1982.—To the extent provided in regulations, no addition to tax shall be made under section 6654 or 6655 of the Internal Revenue Code of 1954 for the taxpayer's first taxable year ending after December 31, 1982, by reason of a long-term contract, but only with respect to installments required to be paid before April 13, 1983."

SEC. 103. TECHNICAL CORRECTIONS OF PENSION PROVISIONS.

(a) AMENDMENTS RELATED TO SECTION 235.—

(1) ACTUARIAL ADJUSTMENTS MADE TO BENEFIT LIMIT RATHER THAN TO BENEFIT.—

(A) Subparagraph (C) of section 415(b)(2) (relating to adjustment to $90,000 limit where benefit begins before age 62) is amended by striking out the first sentence and inserting in lieu thereof the following: "If the retirement income benefit under the plan begins before age 62, the determination as to whether the $90,000 limitation set forth in paragraph (1)(A) has been satisfied shall be made, in accordance with regulations prescribed by the Secretary, by reducing the limitation of paragraph (1)(A) so that such limitation (as so reduced) equals an annual benefit (beginning when such retirement income benefit begins) which is equivalent to a $90,000 annual benefit beginning at age 62."

(B) Subparagraph (D) of section 415(b)(2) (relating to adjustment to $90,000 limitation where benefit begins after age 65) is amended to read as follows:

"(D) ADJUSTMENT TO $90,000 LIMIT WHERE BENEFIT BEGINS AFTER AGE 65.—If the

retirement income benefit under the plan begins after age 65, the determination as to whether the $90,000 limitation set forth in paragraph (1)(a) has been satisfied shall be made, in accordance with regulations prescribed by the Secretary, by increasing the limitation of paragraph (1)(A) so that such limitation (as so increased) equals an annual benefit (beginning when such retirement income benefit begins) which is equivalent to a $90,000 annual benefit beginning at age 65."

(C)(i) Clauses (i) and (iii) of section 415(b)(2)(E) are each amended by striking out "any benefit" and inserting in lieu thereof "any benefit or limitation".

(ii) Clause (ii) of section 415(b)(2)(E) is amended by striking out "any benefit" and inserting in lieu thereof "any limitation".

(2) DEFINITION OF CURRENT ACCRUED BENEFIT IN THE CASE OF COLLECTIVELY BARGAINED PLANS.—Clause (i) of section 235(g)(4)(B) of the Tax Equity and Fiscal Responsibility Act of 1982 (defining current accrued benefit) is amended by adding at the end thereof the following new sentence: "In the case of any plan described in the first sentence of paragraph (5), the preceding sentence shall be applied by substi-

tuting for 'January 1, 1983' the applicable date determined under paragraph (5)."

(3) TRANSITION FRACTION ONLY APPLIES TO PLANS IN EXISTENCE BEFORE JULY 1, 1982.—Paragraph (6) of section 415(e) (relating to special transition rule for defined contribution fraction for years ending after December 31, 1982) is amended by adding at the end thereof the following new subparagraph:

"(C) PLAN MUST HAVE BEEN IN EXISTENCE ON OR BEFORE JULY 1, 1982.—This paragraph shall apply only to plans which were in existence on or before July 1, 1982."

(b) AMENDMENTS RELATED TO SECTION 236.—

(1) EXCEPTION FOR CERTAIN LOANS NOT TO APPLY TO LOANS FROM DEDUCTIBLE EMPLOYEE CONTRIBUTIONS.—

(A) Subparagraph (A) of section 72(o)(3) (relating to amounts constructively received) is amended by striking out "subsection (p)" and inserting in lieu thereof "subsection (p) (other than the exception contained in paragraph (2) thereof)".

(B) Subparagraph (A) of section 72(p)(2) (relating to exception for certain loans) is amended

by adding at the end thereof the following new sentence:

"For purposes of clause (ii), the present value of the nonforfeitable accrued benefit shall be determined without regard to any accumulated deductible employee contributions (as defined in subsection (o)(5)(B))."

(2) DEFINITION OF REQUIRED PRINCIPAL PAYMENT.—Subparagraph (C) of section 236(c)(2) of the Tax Equity and Fiscal Responsibility Act of 1982 is amended by inserting before the period at the end thereof the following: "or if such loan was payable on demand".

(3) REPEAL OF PROVISION TREATING CERTAIN LOAN REPAYMENTS AS CONTRIBUTIONS.—Subsection (f) of section 404 (relating to certain loan repayments considered as contributions) is hereby repealed.

(4) CLARIFICATION OF EXCEPTION FOR SMALL LOANS.—Clause (ii) of section 72(p)(2)(A) (relating to exception for certain loans) is amended to read as follows:

"(ii) the greater of (I) one-half of the present value of the nonforfeitable accrued benefit of the employee under the plan, or (II) $10,000."

(c) AMENDMENTS RELATED TO SECTION 237.—

(1) AMENDMENTS CONFORMING TO LIMITING TO KEY EMPLOYEES THE PENALTY FOR PREMATURE DISTRIBUTIONS.—

(A) Clause (i) of section 72(m)(5)(A) is amended by striking out "as an owner-employee" and inserting in lieu thereof "as a key employee".

(B) The paragraph heading of section 72(m)(5) is amended by striking out "OWNER-EMPLOYEES" and inserting in lieu thereof "KEY EMPLOYEES".

(C) Sections 46(a)(4), 53(a), and 901(a) are each amended by striking out "tax on premature distributions to owner-employees" and inserting in lieu thereof "tax on premature distributions to key employees".

(2) CORECTION OF CROSS REFERENCE TO DEFINITION OF BANK.—

(A) Subsection (f) of section 401 is amended by striking out "(as defined in subsection (d)(1))" and inserting in lieu thereof "(as defined in section 408(n))".

(B) Subsection (h) of section 408 is amended by striking out "(as defined in section 401(d)(1))"

and inserting in lieu thereof "(as defined in subsection (n))".

(3) LIMITATION ON ROLLOVERS TO APPLY ONLY TO KEY EMPLOYEES.—Clause (ii) of section 402(a)(5)(E) (relating to self-employed individuals and owner-employees) is amended to read as follows:

"(ii) KEY EMPLOYEES.—An eligible retirement plan described in subclause (IV) or (V) of subparagraph (D)(iv) shall not be treated as an eligible retirement plan for the transfer of a distribution if any part of the distribution is attributable to contributions made on behalf of the employee while he was a key employee in a top-heavy plan. For purposes of the preceding sentence, the terms 'key employee' and 'top-heavy plan' have the same respective meanings as when used in section 416."

(d) AMENDMENTS RELATED TO SECTION 238.—

(1) REPEAL OF SECTION 72(m)(9).—Paragraph (9) of section 72(m) (relating to return of excess contributions before due date of return) is hereby repealed.

(2) INCREASE IN AMOUNT OF DEDUCTION FOR SIMPLIFIED EMPLOYEE PENSIONS.—Clause (ii) of section 219(b)(2)(A) (relating to special rules for employer

contributions under simplified employee pensions) is amended by striking out "but not in excess of $15,000" and inserting in lieu thereof "but not in excess of the limitation in effect under section 415(c)(1)(A)".

(3) REPEAL OF SECTION 401(e).—Subsection (e) of section 401 (relating to contributions for premiums on annuity, etc., contracts) is hereby repealed.

(4) REPEAL OF SECTION 404(a)(9).—Subsection (a) of section 404(a) is amended by striking out paragraph (9) and by redesignating paragraph (10) as paragraph (9).

(5) REPEAL OF SECTION 404(h)(4).—Paragraph (4) of section 404(h) (relating to effect on self-employed individuals or shareholder employees) is hereby repealed.

(6) DETERMINATION OF EARNED INCOME OF SELF-EMPLOYED FOR PURPOSES OF SECTION 404(a)(8)(C).—Subparagraph (C) of section 404(a)(8) is amended by striking out "the earned income of such individual" and inserting in lieu thereof "the earned income of such individual (determined without regard to the deductions allowed by this section and section 405(c))".

(7) REPEAL OF SECTION 415(c)(7).—

(A) Subsection (c) of section 415 is amended by striking out paragraph (7) and by redesignating paragraph (8) as paragraph (7).

(B) Subclause (II) of section 415(e)(3)(B)(ii) is amended by striking out "subsection (c)(7) or (8)" and inserting in lieu thereof "subsection (c)(7)".

(e) AMENDMENT RELATED TO SECTION 239.—Subparagraph (B) of section 101(b)(3) (relating to treatment of self-employed individuals for exclusion of employees' death benefits) is amended to read as follows:

"(B) SPECIAL RULE FOR CERTAIN DISTRIBUTIONS.—In the case of any amount paid or distributed—

"(i) by a trust described in section 401(a) which is exempt from tax under section 501(a), or

"(ii) under a plan described in section 403(a),

the term 'employee' includes a self-employed individual described in section 401(c)(1)."

(f) AMENDMENTS RELATED TO SECTION 240.—

(1) DEFINITION OF KEY EMPLOYEE.—

(A) Subparagraph (A) of section 416(i)(1) (defining key employee) is amended by striking out

"any participant in an employer plan" and inserting in lieu thereof "an employee".

(B) Clause (ii) of section 416(i)(1)(A) is amended to read as follows:

"(ii) 1 of the 10 employees having annual compensation from the employer of more than the limitation in effect under section 415(c)(1)(A) and owning (or considered as owning within the meaning of section 318) the largest interests in the employer,".

(C) Subparagraph (A) of section 416(i)(1) (defining key employee) is amended by adding at the end thereof the following new sentence: "For purposes of clause (ii), if 2 employees have the same interest in the employer, the employee having greater annual compensation from the employer shall be treated as having a larger interest."

(D) Subparagraph (C) of section 416(i)(1) is amended by striking out "DETERMINING 5-PERCENT OR 1-PERCENT OWNERS" in the subparagraph heading and inserting in lieu thereof "DETERMINING OWNERSHIP IN THE EMPLOYER".

(2) TREATMENT OF SIMPLIFIED EMPLOYEE PENSIONS.—Paragraph (1) of section 408(k) (defining

simplified employee pension) is amended to read as follows:

"(1) IN GENERAL.—For purposes of this title, the term 'simplified employee pension' means an individual retirement account or individual retirement annuity—

"(A) with respect to which the requirements of paragraphs (2), (3), (4), and (5) of this subsection are met, and

"(B) if such account or annuity is part of a top-heavy plan (as defined in section 416), with respect to which the requirements of section 416(c)(2) are met."

(3) CLARIFICATION OF TRANSITIONAL RULE.—Paragraph (3) of section 235(g) of the Tax Equity and Fiscal Responsibility Act of 1982 is amended by adding at the end thereof the following new sentence: "A similar rule shall apply with respect to the last plan year beginning before January 1, 1984, for purposes of applying section 416(h) of the Internal Revenue Code of 1954."

(4) TREATMENT OF DISTRIBUTIONS FROM TERMINATED PLANS.—Paragraph (3) of section 416(g) (relating to distributions during last 5 years taken into account) is amended by adding at the end thereof the following new sentence: "The preceding sentence shall

also apply to distributions under a terminated plan which if it had not been terminated would have been required to be included in an aggregation group."

(5) CLARIFICATION OF COST-OF-LIVING ADJUSTMENTS.—

(A) IN GENERAL.—Paragraph (2) of section 416(d) (relating to cost-of-living adjustments) is amended by striking out "in the same manner" and inserting in lieu thereof "at the same time and in the same manner".

(B) SIMPLIFIED EMPLOYEE PENSIONS.—Subparagraph (C) of section 408(k)(3) (relating to contributions must bear uniform relationship to total compensation) is amended by adding at the end thereof the following new sentence: "The Secretary shall annually adjust the $200,000 amount contained in the preceding sentence at the same time and in the same manner as he adjusts the dollar amount contained in section 415(c)(1)(A)."

(6) CLERICAL AMENDMENTS.—

(A) Subsection (f) of section 416 is amended by striking out "require" and inserting in lieu thereof "required".

(B) Clause (iii) of section 416(i)(1)(B) is amended by striking out "subparagraph (A)(ii)(II)" and inserting in lieu thereof "subparagraph (A)(ii)".

(g) AMENDMENTS RELATED TO SECTION 242.—

(1) DEFINITION OF KEY EMPLOYEE AND TOP-HEAVY PLAN.—

(A) Clause (i) of section 401(a)(9)(A) (relating to required distributions before death) is amended to read as follows:

"(i) either will be distributed to him not later than the later of—

"(I) his taxable year in which he attains age 70½, or

"(II) his taxable year in which he retires, or".

(B) Subparagraph (A) of section 401(a)(9) is amended by adding at the end thereof the following new sentence: "Subclause (II) of clause (i) shall not apply with respect to any employee who was a key employee (as defined in section 416) in a top-heavy plan (as defined in section 416) for the plan year ending in the taxable year in which he attains age 70½."

(2) EXCEPTION WHERE ANNUITY PURCHASED FOR CERTAIN DEPENDENTS.—Paragraph (9) of section 401(a) is amended by adding at the end thereof the following new subparagraph:

"(C) EXCEPTION WHERE DISTRIBUTIONS MADE IN FORM OF ANNUITY TO CERTAIN DEPENDENTS.—

"(i) IN GENERAL.—Subparagraph (B) shall not apply if the entire interest of the employee (or the remaining part of such interest if distribution thereof has commenced) will be distributed (commencing not later than 1 year after the employee's death or the death of his surviving spouse)—

"(I) to a beneficiary who was a qualified dependent of the employee, and

"(II) in accordance with regulations prescribed by the Secretary over a qualified period.

"(ii) QUALIFIED DEPENDENT.—For purposes of this subparagraph, the term 'qualified dependent' means any individual who was a dependent (as defined in section 152) of the employee for the taxable year in

which the employee died (or the preceding taxable year) and who (as of the date of the employee's death)—

"(I) is under the age of 22, or

"(II) is permanently and totally disabled (within the meaning of section 37(e)(3)).

"(iii) QUALIFIED PERIOD.—For purposes of this subparagraph, the term 'qualified period' means—

"(I) in the case of a qualified dependent described in clause (i)(I), a term certain not extending beyond the month in which the dependent attains age 22, or

"(II) in the case of qualified dependent described in clause (i)(II), the life of such dependent or a term certain not extending beyond the life expectancy of such dependent."

(3) CLARIFICATION OF TRANSITIONAL RULE.—

(A) Subparagraph (B) of section 242(b)(2) of the Tax Equity and Fiscal Responsibility Act of 1982 is amended by striking out "paragraph (9) of".

(B) Paragraph (2) of section 242(b) of such Act is amended by striking out "January 1, 1984" and inserting in lieu thereof "the first day of the first plan year beginning on or after January 1, 1984".

(C) Subsection (b) of section 242 of such Act is amended by adding at the end thereof the following new paragraph:

"(3) TREATMENT OF CERTAIN DEFAULT OPTIONS.—For purposes of paragraph (2), if—

"(A) a plan permits an employee to designate a method of distribution but provides that in the absence of such a designation a specified method of distribution will apply, and

"(B) as of the first day of the first plan year beginning on or after January 1, 1984, such specified method of distribution applied to an individual by reason of his failure to make a designation which was available to him before such first day,

such specified method of distribution shall be treated as pursuant to a designation made by the employee before the first day of such plan year."

(4) SPECIAL RULE FOR COLLECTIVE-BARGAINING AGREEMENTS.—Paragraph (5) of section 235(g) of the

Tax Equity and Fiscal Responsibility Act of 1982 is amended—

(A) by striking out "section 253" each place it appears and inserting in lieu thereof "section 242", and

(B) by adding at the end thereof the following new sentence: "In the case of any plan described in the first sentence of this paragraph, paragraphs (2) and (3) of section 242(b) shall be applied by substituting for 'January 1, 1984' the applicable date determined under this paragraph."

(5) CLARIFICATION THAT REQUIRED DISTRIBUTIONS MAY BE MADE TO OTHER BENEFICIARIES.—Clause (ii) of section 401(a)(9)(A) is amended by inserting "to the employee or any of his beneficiaries" after "will be distributed".

(6) DELAY IN EFFECTIVE DATE FOR GOVERNMENT PLANS.—Subsection (b) of section 242 of the Tax Equity and Fiscal Responsibility Act of 1982 is amended by adding at the end thereof the following new paragraph:

"(4) SPECIAL RULE FOR GOVERNMENT PLANS.—In the case of a government plan (as defined in section 219(e)(4) of the Internal Revenue Code of 1954)—

"(A) paragraph (1) shall be applied by substituting 'December 31, 1984' for 'December 31, 1983', and

"(B) paragraphs (2) and (3) shall be applied by substituting 'January 1, 1985' for 'January 1, 1984'."

(h) AMENDMENTS RELATED TO SECTION 243.—

(1) EFFECTIVE DATE FOR PROVISIONS RELATED TO INHERITED INDIVIDUAL RETIREMENT PLANS.—Subsection (c) of section 243 of the Tax Equity and Fiscal Responsibility Act of 1982 is amended to read as follows:

"(c) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to individuals dying after December 31, 1983."

(2) CLERICAL AMENDMENT.—The subparagraph (C) of section 408(d)(3) which was added by section 335(a)(1) of the Tax Equity and Fiscal Responsibility Act of 1982 is redesignated as subparagraph (D).

(i) AMENDMENT RELATED TO SECTION 247.—Subsection (a) of section 247 of the Tax Equity and Fiscal Responsibility Act of 1982 (relating to existing personal service corporations may liquidate under section 333 during 1983 and 1984) is amended by inserting "which is in existence on Sep-

tember 3, 1982," after "section 535(c)(2)(B) of the Internal Revenue Code of 1954)".

(j) AMENDMENT RELATED TO SECTION 249.—Subparagraph (D) of section 408(k)(3) (relating to treatment of certain contributions and taxes) is amended by striking out the second and third sentences and inserting in lieu thereof the following: "If the employer does not maintain an integrated plan at any time during the taxable year, OASDI contributions (as defined in section 401(l)(2)) may, for purposes of this paragraph, be taken into account as contributions by the employer to the employee's simplified employee pension, but only if such contributions are so taken into account with respect to each employee maintaining a simplified employee pension."

(k) AMENDMENTS RELATED TO SECTION 253.—

(1) LIMITATION OF PROFIT-SHARING AND STOCK BONUS PLANS.—Subparagraph (C) of section 415(c)(3) is amended by striking out "In the case of a participant" and inserting in lieu thereof "In the case of a participant in a profit-sharing or stock bonus plan".

(2) CLARIFICATION OF RULE THAT CONTRIBUTIONS BE NONFORFEITABLE.—Subparagraph (C) of section 415(c)(3) (relating to special rules for permanent and total disability) is amended by striking out the last sentence and inserting in lieu thereof the following:

"This subparagraph shall apply only if contributions made with respect to amounts treated as compensation under this subparagraph are nonforfeitable when made."

SEC. 104. MISCELLANEOUS PROVISIONS.

(a) AMENDMENT RELATED TO SECTION 292.—Paragraph (2) of section 7430(a) (relating to awarding of court costs and certain fees) is amended by striking out "including the Tax Court" and inserting in lieu thereof "including the Tax Court and the United States Claims Court".

(b) AMENDMENTS RELATED TO SECTION 334.—

(1) CLARIFICATION THAT DEATH BENEFIT EXCLUSION APPLIES TO DISTRIBUTIONS UNDER SECTION 403(b).—Subparagraph (C) of section 3405(b)(2) (relating to special rule for distributions by reason of death) is amended to read as follows:

"(C) SPECIAL RULE FOR DISTRIBUTIONS BY REASON OF DEATH.—In the case of any nonperiodic distribution from or under any plan or contract described in section 401(a), 403(a), or 403(b)—

"(i) which is made by reason of a participant's death, and

"(ii) with respect to which the requirements of clauses (ii) and (iv) of subsection (d)(4)(A) are met,

subparagraph (A) or (B) (as the case may be) shall be applied by taking into account the exclusion from gross income provided by section 101(b) (whether or not allowable)."

(2) CLARIFICATION OF CREDIT FOR WITHHELD AMOUNTS.—Paragraph (1) of section 31(a) is amended by striking out "under section 3402 as tax on the wages of any individual" and inserting in lieu thereof "as tax under chapter 24".

(3) PENALTY FOR FAILURE TO GIVE NOTICE.—Section 6652 (relating to penalty for failure to file certain information returns, registration statements, etc.) is amended by redesignating subsection (i) as subsection (j) and by inserting after subsection (h) the following new subsection:

"(i) FAILURE TO GIVE NOTICE TO RECIPIENTS OF CERTAIN PENSION, ETC., DISTRIBUTIONS.—In the case of each failure to provide notice as required by section 3405(d)(10)(B), at the time prescribed therefor, unless it is shown that such failure is due to reasonable cause and not to willful neglect, there shall be paid, on notice and demand of the Secretary and in the same manner as tax, by the person

failing to provide such notice, an amount equal to $10 for each such failure, but the total amount imposed on such person for all such failures during any calendar year shall not exceed $5,000."

(4) EXCEPTION FOR AMOUNTS PAID TO NONRESIDENT ALIENS.—Subparagraph (B) of section 3405(d)(1) (relating to exceptions) is amended by striking out "and" at the end of clause (i), by striking out the period at the end of clause (ii) and inserting in lieu thereof ", and", and by adding at the end thereof the following new clause:

"(iii) any amount which is subject to withholding under subchapter A of chapter 3 (relating to withholding of tax on nonresident aliens and foreign corporations) by the person paying such amount or which would be so subject but for a tax treaty."

(5) CLARIFICATION OF AMOUNT WITHHELD WHERE EMPLOYER SECURITY DISTRIBUTED.—Paragraph (8) of section 3405(d) (relating to maximum amount withheld) is amended by adding at the end thereof the following new sentence: "No amount shall be required to be withheld under this section in the case of any designated distribution which consists only of employer securities of the employer corporation

(within the meaning of section 402(a)(3)) and cash (not in excess of $200) in lieu of fractional shares."

(c) AMENDMENT RELATED TO SECTION 337.—Subsection (d) of section 982 (relating to admissibility of documentation maintained in foreign countries) is amended by striking out paragraph (3) and by redesignating paragraph (4) as paragraph (3).

(d) AMENDMENT RELATED TO SECTION 339.—Paragraph (1) of section 6038A(c) (defining control) is amended by striking out "section 6038(d)(1)" and inserting in lieu thereof "section 6038(e)(1)".

(e) AMENDMENT RELATED TO SECTION 345.—Subsection (b) of section 345 of the Tax Equity and Fiscal Responsibility Act of 1982 (relating to effective date) is amended by striking out "taking effect on" and inserting in lieu thereof "taking effect on or after".

SEC 105. EFFECTIVE DATE.

Any amendment made by this title shall take effect as if included in the provision of the Tax Equity and Fiscal Responsibility Act of 1982 to which such amendment related.

TITLE II—TECHNICAL CORRECTIONS OF SUBCHAPTER S REVISION ACT OF 1982; ETC.

SEC. 201. TECHNICAL CORRECTIONS OF SUBCHAPTER S REVISION ACT OF 1982.

(a) LIMITATION ON RECOGNITION OF GAIN IN THE CASE OF CERTAIN DISTRIBUTIONS.—

(1) Section 1363 (relating to effect of election on corporation) is amended by adding at the end thereof the following new subsection:

"(e) SUBSECTION (d) NOT TO APPLY TO COMPLETE LIQUIDATIONS AND REORGANIZATIONS.—Subsection (d) shall not apply to any distribution—

"(1) of property in complete liquidation of the corporation, or

"(2) to the extent it consists of property permitted by section 354, 355, or 356 to be received without the recognition of gain."

(2) Subsection (d) of section 1363 is amended by striking out "If" and inserting in lieu thereof "Except as provided in subsection (e), if".

(b) COORDINATION WITH RULES RELATING TO INCOME FROM DISCHARGE OF INDEBTEDNESS.—

(1) Paragraph (2) of section 1363(c) (relating to elections of the S corporation) is amended by striking

out subparagraph (A) and by redesignating subparagraphs (B), (C), and (D) as subparagraphs (A), (B), and (C), respectively.

(2) Subsection (d) of section 108 (relating to income from discharge of indebtedness) is amended by redesignating paragraphs (7), (8), and (9) as paragraphs (8), (9), and (10), respectively, by striking out paragraph (6), and by inserting after paragraph (5) the following new paragraphs:

"(6) SUBSECTIONS (a), (b), AND (c) TO BE APPLIED AT PARTNER LEVEL.—In the case of a partnership, subsections (a), (b), and (c) shall be applied at the partner level.

"(7) SPECIAL RULES FOR S CORPORATION.—

"(A) SUBSECTIONS (a), (b), AND (c) TO BE APPLIED AT CORPORATE LEVEL.—In the case of an S corporation, subsections (a), (b), and (c) shall be applied at the corporate level.

"(B) REDUCTION IN CARRYOVER OF DISALLOWED LOSSES AND DEDUCTIONS.—In the case of an S corporation, for purposes of subparagraph (A) of subsection (b)(2), any loss or deduction which is disallowed for the taxable year of the discharge under section 1366(d)(1) shall be treated as a net operating loss for such taxable year.

"(C) COORDINATION WITH BASIS ADJUSTMENTS UNDER SECTION 1367(b)(2).—For purposes of subsection (e)(6), a shareholder's adjusted basis in indebtedness of an S corporation shall be determined without regard to any adjustments made under section 1367(b)(2)."

(c) TREATMENT OF INACTIVE SUBSIDIARIES.—Paragraph (6) of section 1361(c) (relating to ownership of stock in certain inactive corporations) is amended—

(1) by striking out "the close of such taxable year" in subparagraph (A) and inserting in lieu thereof "such time", and

(2) by striking out subparagraph (B) and inserting in lieu thereof the following:

"(B) does not have gross income for the period (including within such taxable year) before such time."

(d) TREATMENT OF WORTHLESS DEBT.—Paragraph (3) of section 1367(b) (relating to coordination with section 165(g)) is amended to read as follows:

"(3) COORDINATION WITH SECTIONS 165(g) AND 166(d).—This section and section 1366 shall be applied before the application of sections 165(g) and 166(d) to any taxable year of the shareholder or the corporation in which the security or debt becomes worthless."

(e) ADJUSTMENT TO EARNINGS AND PROFITS FOR RECAPTURE UNDER SECTION 47.—

(1) Subsection (d) of section 1371 (relating to coordination with investment credit recapture) is amended by adding at the end thereof the following new paragraph:

"(3) ADJUSTMENT TO EARNINGS AND PROFITS FOR AMOUNT OF RECAPTURE.—Paragraph (1) of subsection (c) shall not apply to any increase in tax under section 47 for which the S corporation is liable."

(2) Paragraph (1) of section 1371(c) is amended by striking out "paragraphs (2) and (3)" and inserting in lieu thereof "paragraphs (2) and (3) and subsection (d)(3)".

(f) QUALIFIED SUBCHAPTER S TRUSTS.—

(1) GRACE PERIOD.—Subparagraph (D) of section 1361(d)(2) (relating to grace period) is amended by striking out "60 days" and inserting in lieu thereof "75 days".

(2) DEFINITION OF QUALIFIED SUBCHAPTER S TRUST.—

(A) Subparagraph (B) of section 1361(d)(3) (defining qualified subchapter S trust) is amended by striking out "is distributed (or required to be

distributed) currently" and inserting in lieu thereof "is required to be distributed currently".

(B) The amendment made by subparagraph (A) shall not apply to any trust with respect to which an election was made under section 1361(d)(2) of the Internal Revenue Code of 1954 before the date of the enactment of this Act.

(3) TECHNICAL AMENDMENTS.—

(A) Clause (i) of section 1361(d)(2)(B) (relating to separate election with respect to each S corporation) is amended by striking out "S corporation" each place it appears and inserting in lieu thereof "corporation".

(B) Paragraph (3) of section 1361(d) (defining qualified subchapter S trust) is amended by striking out subparagraph (A) and by redesignating subparagraphs (B) and (C) as subparagraphs (A) and (B), respectively.

(g) COORDINATION WITH SECTION 338.—

(1) Paragraph (6) of section 1362(e) (relating to treatment of S termination year) is amended by adding at the end thereof the following new subparagraph:

"(C) PARAGRAPH (2) NOT TO APPLY TO ITEMS RESULTING FROM SECTION 338.—Para-

graph (2) shall not apply with respect to any item resulting from the application of section 338."

(2) Paragraph (2) of section 1362(e) is amended by striking out "as provided in paragraph (3)" and inserting in lieu thereof "as provided in paragraphs (3) and (6)(C)".

(h) ELECTION TO HAVE NEW PASSIVE INCOME RULES NOT APPLY DURING 1982.—Paragraph (3) of section 6(b) of the Subchapter S Revision Act of 1982 (relating to new passive income rules apply to taxable years beginning during 1982) is amended by adding at the end thereof the following new sentences: "The preceding sentence shall not apply in the case of any corporation which elects (at such time and in such manner as the Secretary of the Treasury or his delegate shall prescribe) to have such sentence not apply. Subsection (e) shall not apply to any termination resulting from an election under the preceding sentence."

(i) S CORPORATION TREATED AS PARTNERSHIP FOR PURPOSES OF SECTION 318.—Paragraph (5) of section 318(a) (relating to constructive ownership of stock) is amended by adding at the end thereof the following new subparagraphs:

"(E) S CORPORATION TREATED AS PARTNERSHIP.—For purposes of this subsection—

"(i) an S corporation shall be treated as a partnership, and

"(ii) any shareholder of the S corporation shall be treated as a partner of such partnership.

The preceding sentence shall not apply for purposes of determining whether stock in the S corporation is constructively owned by any person."

(j) CLARIFICATION OF TREATMENT OF CERTAIN ELECTIONS UNDER PRIOR LAW.—Subsection (e) of section 6 of the Subchapter S Revision Act of 1982 (relating to treatment of certain elections under prior law) is amended by striking out "any termination" and inserting in lieu thereof "any termination or revocation".

"(k) ELECTIONS FOR CERTAIN SHORT TAXABLE YEARS.—Subsection (b) of section 1362 (relating to when subchapter S election made) is amended by adding at the end thereof the following new paragraph:

"(4) TAXABLE YEARS OF 2½ MONTHS OR LESS.—For purposes of this subsection, an election for a taxable year made not later than 2 months and 15 days after the first day of the taxable year shall be treated as timely made during such year."

(l) CLERICAL AMENDMENTS.—

(1) Subparagraph (B) of section 465(a)(1) (relating to limitation to amount at risk) is amended by striking out "a corporation" and inserting in lieu thereof "a C corporation".

(2) Subsection (e) of section 1371 (relating to cash distributions during post-termination transition period) is amended by inserting before the period at the end thereof the following: "(within the meaning of section 1368(e))".

(3) Paragraph (2) of section 6659(f) is amended by striking out "section 465(a)(1)(C)" and inserting in lieu thereof "section 465(a)(1)(B)".

(m) EFFECTIVE DATE.—Any amendment made by this section shall take effect as if included in the Subchapter S Revision Act of 1982.

SEC. 202. MISCELLANEOUS PROVISIONS.

(a) AMENDMENTS RELATED TO TECHNICAL CORRECTIONS ACT OF 1982.—

(1) Paragraph (12) of section 57(a) (relating to accelerated cost recovery deduction) is amended—

(A) by striking out "(or, in the case of property described in section 167(k), under section 167)" in subparagraph (A), and

(B) by inserting "(or, in the case of property described in section 167(k), under section 167)" after "section 168(a)" in subparagraph (B).

(2) Subparagraph (A) of section 1256(g)(1) (defining foreign currency contract) is amended by inserting after "regulated futures contracts" the following: "(or the settlement of which depends on the value of such a currency)".

(3) Subclause (I) of section 306(a)(8)(A)(ii) of the Technical Corrections Act of 1982 is amended by striking out "the date of the enactment of the Tax Equity and Fiscal Responsibility Act of 1982" and inserting in lieu thereof "September 1, 1982".

(4) Any amendment made by this subsection shall take effect as if included in the provisions of the Technical Corrections Act of 1982 to which such amendment relates.

(b) COORDINATION OF CERTAIN AMENDMENTS MADE BY HIGHWAY REVENUE ACT OF 1982 AND PUBLIC LAW 97–473.—For purposes of applying the amendments made by section 547 of the Highway Revenue Act of 1982 and the amendment made by section 202(b)(2) of Public Law 97–473, Public Law 97–473 shall be deemed to have been enacted immediately before the Highway Revenue Act of 1982.

TITLE III—AMENDMENTS RELATING TO HIGHWAY REVENUE ACT OF 1982

SEC. 301. VALUE OF USED COMPONENTS FURNISHED BY FIRST USER NOT TAKEN INTO ACCOUNT IN DETERMINING PRICE.

Subparagraph (B) of section 4052(b)(1) (relating determination of price) is amended by striking out "and" at the end of clause (ii) and by inserting after clause (iii) the following new clause:

"(iv) the value of any component of such article if—

"(I) such component is furnished by the first user of such article, and

"(II) such component has been used before such furnishing, and".

SEC. 302. CLARIFICATION OF APPLICATION OF GASOLINE EXCISE TAX TO GASOHOL, ETC.

(a) GASOLINE EXCISE TAX TO APPLY TO GALLON OF GASOHOL.—

(1) IN GENERAL.—Paragraph (1) of section 4081(c) (relating to gasoline mixed with alcohol) is amended to read as follows:

"(1) IN GENERAL.—Under regulations prescribed by the Secretary, subsection (a) shall be applied—

"(A) by substituting '4 cents' for '9 cents' in the case of the sale of any gasohol (the gasoline in which was not taxed under subparagraph (B)), and

"(B) by substituting '4⅘ cents' for '9 cents' in the case of the sale of any gasoline for use in producing gasohol.

For purposes of this paragraph, the term 'gasohol' means any mixture of gasoline if at least 10 percent of such mixture is alcohol."

(2) LATER SEPARATION OF GASOLINE.—Paragraph (2) of section 4081(c) is amended—

(A) by striking out "at the rate of 4 cents a gallon" and inserting in lieu thereof "at a rate equivalent to 4 cents a gallon", and

(B) by striking out "5 cents a gallon" and inserting in lieu thereof "4⅘ cents a gallon".

(3) CREDIT OR REFUND.—Paragraph (1) of section 6427(f) (relating to gasoline used to produce certain alcohol fuels) is amended by striking out "5 cents" and inserting in lieu thereof "4⅘ cents".

(b) LOWER FLOOR STOCKS TAX ON GASOHOL.—Subsection (a) of section 521 of the Highway Revenue Act of 1982 is amended by inserting "(4 cents a gallon in the case

of a gallon of gasohol, as defined in section 4081(c))" after "5 cents a gallon".

SEC. 303. OTHER TECHNICAL AMENDMENTS.

(a) FLOOR STOCKS REFUNDS FOR TIRES TAXED AT LOWER RATE AFTER JANUARY 1, 1984.—

(1) IN GENERAL.—Paragraph (1) of section 522(b) of the Highway Revenue Act of 1982 (relating to floor stocks refunds for tires) is amended by inserting "(or will be subject to a lower rate of tax under such section)" after "and which will not be subject to tax under such section".

(2) AMOUNT OF REFUND LIMITED TO REDUCTION IN TAX.—Paragraph (2) of section 522(b) of such Act is amended by adding at the end thereof the following: "In the case of any tire which is a tax repealed article solely by reason of the parenthetical matter in paragraph (1), the amount of the credit or refund under subsection (a) shall not exceed the excess of the tax imposed with respect to such tire by section 4071(a) as in effect on December 31, 1983, over the tax which would have been imposed with respect to such tire by section 4071(a) on January 1, 1984."

(b) OVERPAYMENTS OF TAX ON TRUCKS, ETC., AND TIRES.—

(1) TRUCKS, ETC.—

(A) IN GENERAL.—Subsection (b) of section 6416 (relating to special cases in which tax payments considered overpayments) is amended by inserting after paragraph (5) the following new paragraph:

"(6) TRUCK CHASSIS, BODIES, AND SEMITRAILERS USED FOR FURTHER MANUFACTURE.—If—

"(A) the tax imposed by section 4051 has been paid with respect to the sale of any article, and

"(B) before any other use, such article is by any person used as a component part of another article taxable under section 4051 manufactured or produced by him,

such tax shall be deemed to be an overpayment by such person. For purposes of the preceding sentence, an article shall be treated as having been used as a component part of another article if, had it not been broken or rendered useless in the manufacture or production of such other article, it would have been so used."

(B) TECHNICAL AMENDMENT.—Subparagrah (B) of section 6416(a)(2) is amended by striking out "or (5)" and inserting in lieu thereof "(5), or (6)".

(2) TIRES.—

(A) IN GENERAL.—Paragraph (4) of section 6416(b) (relating to tires) is amended to read as follows:

"(4) TIRES.—If—

"(A) the tax imposed by section 4071 has been paid with respect to the sale of any tire by the manufacturer, producer, or importer thereof, and

"(B) such tire is sold by any person on or in connection with, or with the sale of, any other article, such tax shall be deemed to be an overpayment by such person if such other article is—

"(i) an automobile bus chassis or an automobile bus body, or

"(ii) by such person exported, sold to a State or local government for the exclusive use of a State or local government, sold to a nonprofit educational organization for its exclusive use, or used or sold for use as supplies for vessels or aircraft."

(B) TECHNICAL AMENDMENTS.—

(i) Paragraph (2) of section 6416(b) is amended by striking out subparagraph (E).

(ii) Paragraph (3) of section 6416(b) (relating to tax-paid articles used for further manufacture, etc.) is amended by striking out subparagraph (C).

(iii) Subparagraph (C) of section 6416(a)(1) is amended by striking out ", (b)(3) (C) or (D), or (b)(4)".

(iv) Subparagraph (B) of section 6416(a)(2), as amended by paragraph (1)(B), is amended by inserting "(4)," before "(5)".

(v) Subparagraph (3) of section 6416(a) is amended to read as follows:

"(3) SPECIAL RULE.—For purposes of this subsection, in any case in which the Secretary determines that an article is not taxable, the term 'ultimate purchaser' (when used in paragraph (1)(B) of this subsection) includes a wholesaler, jobber, distributor, or retailer who, on the 15th day after the date of such determination, holds such article for sale; but only if claim for credit or refund by reason of this paragraph is filed on or before the date for filing the return with respect to the taxes imposed under chapter 32 for the first period which begins more than 60 days after the date on such determination."

(c) PENALTIES, ETC. TO APPLY TO FLOOR STOCKS TAXES.—Subsection (c) of section 521 of the Highway Revenue Act of 1982 is amended by adding at the end thereof the following: "All other provisions of law, including penalties, applicable with respect to the taxes imposed by section 4081 or 4071(a) (whichever is appropriate) shall apply to the floor stocks taxes imposed by this section."

(d) NO 1984 SHORT TAXABLE PERIOD FOR OWNER-OPERATORS.—Subsection (a) of section 4481 (relating to tax on use of certain vehicles), as in effect before the amendments made by the Highway Revenue Act of 1982, is amended by striking out the last sentence.

(e) CLARIFICATION OF SECONDARY LIABILITY OF INSTALLERS OF PARTS AND ACCESSORIES PURCHASED SEPARATELY.—The text of section 4051(b)(3) is amended to read as follows: "The owners of the trade or business installing the parts or accessories shall be secondarily liable for the tax imposed by paragraph (1)."

(f) NO INFERENCE FOR PAST PERIODS TO BE DRAWN FROM AMENDMENT RELATING TO CUSTOMARY USE OF TRAILERS.—The subsection heading of subsection (c) of section 513 of the Highway Revenue Act of 1982 is amended by striking out "Clarification of".

SEC. 304. REPEAL OF CERTAIN PROVISIONS MADE OBSOLETE BY HIGHWAY REVENUE ACT OF 1982.

(a) DELETION OF TERMINATED MANUFACTURERS EXCISE TAX ON MOTOR VEHICLES.—

(1) Part I of subchapter A of chapter 32 is amended by striking out sections 4061, 4062, and 4063.

(2) The part heading and the table of sections for such part I are amended to read as follows:

"PART I—GAS GUZZLERS

"Sec. 4064. Gas guzzlers tax."

(3) The table of parts for subchapter A of chapter 32 is amended by striking out the item relating to part I and inserting in lieu thereof the following:

"Part I. Gas guzzlers."

(b) CROSS-REFERENCES TO TERMINATED MANUFACTURERS EXCISE TAX ON MOTOR VEHICLES STATED AS PART OF RETAIL TAX.—

(1) EXEMPTIONS.—Section 4053 (relating to exemptions from retail tax on heavy trucks, etc.) is amended to read as follows:

"SEC. 4053. EXEMPTIONS.

No tax shall be imposed by section 4051 on any of the following articles:

"(1) CAMPER COACHES BODIES FOR SELF-PROPELLED MOBILE HOMES.—Any article designed—

"(A) to be mounted or placed on automobile trucks, automobile truck chassis, or automobile chassis, and

"(B) to be used primarily as living quarters or camping accommodations.

"(2) FEED, SEED, AND FERTILIZER EQUIPMENT.—Any body primarily designed—

"(A) to process or prepare seed, feed, or fertilizer for use on farms,

"(B) to haul feed, seed, or fertilizer to and on farms,

"(C) to spread feed, seed, or fertilizer on farms,

"(D) to load or unload feed, seed, or fertilizer on farms, or

"(E) for any combination of the foregoing.

"(3) House trailers.—Any house trailer.

"(4) AMBULANCES, HEARSES, ETC.—Any ambulance, hearse, or combination ambulance-hearse.

"(5) CONRETE MIXERS.—ANY ARTICLE DESIGNED—

"(A) to be placed or mounted on an automobile truck chassis or truck trailer or semitrailer chassis, and

(B) to be used to process or prepare concrete.

"(6) TRASH CONTAINERS, ETC.—Any box, container, receptacle, bin or other similar article—

"(A) which is designed to be used as a trash container and is not designed for the transportation of freight other than trash, and

(B) which is not designed to be permanently mounted on or permanently affixed to an automobile truck chassis or body.

"(7) RAIL TRAILERS AND RAIL VANS.—Any chassis or body of a trailer or semitrailer which is designed for use both as a highway vehicle and a railroad car. For purposes of the preceding sentence, piggyback trailer or semitrailer shall not be treated as designed for use as a railroad car."

(2) CERTAIN COMBINATIONS NOT TREATED AS MANUFACTURE.—Subsection (c) of section 4052 (relating to definitions and special rules) is amended to read as follows:

"(c) CERTAIN COMBINATIONS NOT TREATED AS MANUFACTURE.—

"(1) IN GENERAL.—For purposes of this subchapter (other than subsection (a)(3)(B)), a person shall not be treated as engaged in the manufacture of any

article by reason of merely combining such article with any item listed in paragraph (2).

"(2) ITEMS.—The items listed in this paragraph are any coupling device (including any fifth wheel), wrecker cra· · loading and unloading equipment (including any crane, hoist, winch, or power liftgate), aerial ladder or tower, snow and ice control equipment, earthmoving, excavation and construction equipment, spreader, sleeper cab, cab shield, or wood or metal floor."

(c) OTHER TECHNICAL AND CONFORMING AMENDMENTS.—

`(1) Clause (i) of section 48(l)(16)(B) (defining qualified intercity bus) is amended to read as follows:

"(i) the chassis of which is an automobile bus chassis and the body of which is an autombile bus body,".

(2)(A) The first sentence of section 4071(b) is amended by striking out "or inner tube" and by striking out "or tube" each place it appears.

(B) The first sentence of section 4071(c) is amended by striking out "on total weight," and all that follows and inserting in lieu thereof "on total weight exclusive of metal rims or rim bases."

(C) Subsection (e) of section 4071 is amended—

(i) by striking out "or inner tubes (other than bicycle tires and inner tubes)",

(ii) by striking out "and inner tubes" in paragraphs (1) and (2), and

(iii) by striking out the last sentence and inserting in lieu thereof the following: "This subsection shall not apply with respect to the sale of an automobile bus chassis or an automobile bus body."

(D) Subsection (f) of section 4071 (relating to imported recapped or retreaded United States tires) is hereby repealed.

(3) Section 4072 (relating to definitions) is amended by striking out subsection (b) and by redesignating subsection (c) as subsection (b).

(4) Section 4073 (relating to exemptions) is amended to read as follows:

"SEC. 4073. EXEMPTION FOR TIRES WITH INTERNAL WIRE FASTENING.

"The tax imposed by section 4071 shall not apply to tires of extruded tiring with an internal wire fastening agent."

(5)(A) The heading for part II of subchapter A of chapter 32 is amended by striking out "**AND TUBES**".

(B) The table of parts for subchapter A of chapter 32 is amended by striking out "and tubes" in the item relating to part II.

(C) The item relating to section 4073 in the table of sections for part II of subchapter A of chapter 32 is amended to read as follows:

"Sec. 4073. Exemption for tires with internal wire fastening."

(6)(A) Paragraph (1) of section 4216(b) (defining constructive sale price) is amended—

(i) by striking out "(other than an article the sale of which is taxable under section 4061(a))" in the second sentence, and

(ii) by striking out the third sentence.

(B) Paragraph (2) of section 4216(b) is amended by striking out subparagraph (C), by adding "and" at the end of subparagraph (B), and by redesignating subparagraph (D) as subparagraph (C).

(C) Subsection (b) of section 4216 is amended by striking out paragraph (5).

(D) Paragraph (3) of section 4216(b) is amended by striking out "paragraphs (4) and (5)" and inserting in lieu thereof "paragraph (4)".

(E) Paragraph (6) of section 4216(b) is redesignated as paragraph (5) and is amended by striking out "(1), (3), and (5)" and inserting in lieu thereof "(1) and (3)".

(F) Subsection (f) of section 4216 (relating to certain trucks incorporating used components) is hereby repealed.

(7)(A) Subsection (b) of section 4218 (relating to use by manufacturer or importer considered as sale) is amended—

(i) by striking out "or inner tube", and

(ii) by striking out "Except as provided in subsection (d), if" and inserting in lieu thereof "If".

(B) The heading for subsection (b) of section 4218 is amended by striking out "and Tubes".

(C) Section 4218 is amended by striking out subsections (c) and (d) and by redesignating subsection (e) as subsection (c).

(D) Subsection (a) of section 4218 is amended by striking out "(other than an article specified in subsection (b), (c), or (d))" and inserting in lieu thereof "(other than a tire taxable under section 4017)".

(8)(A) Subsection (a) of section 4221 (relating to tax-free sales) is amended by inserting "(or under section 4051 on the first retail sale)" after "manufacturer".

(B) Subsection (c) of section 4221 is amended by striking out "section 4063(a) (6) or (7), 4063(b),

4063(e)," and inserting in lieu thereof "section 4053(a)(6)".

(C) Paragraph (1) of section 4221(d) (defining manufacturer) is amended by inserting before the period ", and, in the case of the tax imposed by section 4051, includes the retailer with respect to the first retail sale".

(D) Paragraph (6) of section 4221(d) (relating to use in further manufacture) is amended—

(i) by striking out subparagraph (B) and the last sentence,

(ii) by striking out "(other than an article referred to in subparagraph (B))" in subparagraph (A),

(iii) by redesignating subparagraph (C) as subparagraph (B), and

(iv) by adding "or" at the end of subparagraph (A).

(E) Paragraph (2) of section 4221(e) is amended—

(i) by striking out "or inner tube" each place it appears; and

(ii) by striking out "or tube" each place it appears.

(F) The heading for paragraph (2) of section 4221(e) is amended by striking out "AND TUBES".

(G) Subsection (e) of section 4221 is amended by striking out paragraphs (4), (5), and (6) and inserting in lieu thereof the following:

"(3) TIRES USED ON INTERCITY, LOCAL, AND SCHOOL BUSES.—Under regulations prescribed by the Secretary, the tax imposed by section 4071 shall not apply in the case of tires sold for use by the purchaser on or in connection with a qualified bus."

(9) Subsection (d) of section 4222 is amended by striking out "4063(a)(7), 4063(b), 4063(e)," and inserting in lieu thereof "4053(a)(6),".

(10) Paragraph (1) of section 4223(b) is amended by striking out "section 4218(e)" and inserting in lieu thereof "4213(c)".

(11) Paragraph (2) of section 4227 is amended by striking out "and tubes".

(12)(A) So much of paragraph (1) of section 6412(a) (relating to floor stock refunds) as precedes "there shall be credited or refunded" is amended to read as follows:

"(1) TIRES AND GASOLINE.—Where before October 1, 1988, any article subject to the tax imposed by section 4071 or 4081 has been sold by the manufactur-

er, producer, or importer and on such date is held by a dealer and has not been used and is intended for sale,".

(B) Paragraph (1) of section 6412(a) is amended by striking out the last sentence.

(C) Subparagraph (A) of section 6412(a)(2) is amended to read as follows:

"(A) The term 'dealer' includes a wholesaler, jobber, distributor, or retailer."

(D) Subsection (c) of section 6412 is amended by striking out "4061, 4071," and inserting in lieu thereof "4071".

(13)(A) Subparagraph (C) of section 6416(b)(1) (relating to adjustment of tire price) is amended by striking out "section 4071(a) (1) or (2) or section 4071(b)" and inserting in lieu thereof "subsection (a) or (b) of section 4071".

(B) Paragraph (2) of section 6416(b) is amended by striking out subparagraph (F) and all that follows to the end thereof and inserting in lieu thereof the following:

"(E) in the case of any tire taxable under section 4071(a), sold to any person for use as described in section 4221(e)(3); or

"(F) in the case of gasoline, used or sold for use in the production of special fuels referred to in section 4041.

Subparagraphs (C) and (D) shall not apply in the case of any tax paid under section 4064."

(C) Paragraph (3) of section 6416(b) is amended by striking out all subparagraphs and the last sentence thereof and inserting in lieu thereof the following:

"(A) in the case of any article other than gasoline taxable under section 4018, such article is used by the subsequent manufacturer or producer as material in the manufacture or production of, or as a component part of—

"(i) another article taxable under chapter 32, or

"(ii) an automobile bus chassis or an automobile bus body,

manufactured or produced by him; or

"(B) in the case of gasoline taxable under section 4081, such gasoline is used by the subsequent manufacturer or producer, for nonfuel purposes, as a material in the manufacture or production of any other article manufactured or produced by him."

(D) Subparagraph (B) of section 6416(a)(2) is amended by striking out "or (B)".

(E) Section 6416 is amended by striking out subsections (c) and (g) and by redesignating subsections (e), (f), (h), and (i) as subsections (c), (d), (e), and (f), respectively.

(F) Subparagraph (A) of section 6416(b)(2) is amended by striking out "(except in any case to which subsection (g) applies)".

(14) Section 6511 is amended by striking out subsection (i) and by redesignating subsection (j) as subsection (i).

(15) Paragraph (3) of section 9502(b) is amended by striking out "under paragraphs (2) and (3) of section 4071(a), with respect to tires and tubes of types used on aircraft" and inserting in lieu thereof "under section 4071 with respect to tires of the types used on aircraft".

(16) Sections 1366(f)(1) and 6401(b) are each amended by striking out ", special fuels, and lubricating oil" and inserting in lieu thereof "and special fuels".

SEC. 305. EFFECTIVE DATE.

Any amendment made by this title shall take effect as if included in the provisions of the Highway Revenue Act of 1982 to which such amendment relates.

TITLE IV—AMENDMENTS TO OTHER LAWS

Subtitle A—Changes in OASDI Provisions

SEC. 401. AMENDMENTS TO TITLE II OF THE SOCIAL SECURITY ACT NECESSITATED BY 1983 AMENDMENTS.

(a) Section 202(c)(1) of the Social Security Act is amended (in the matter appearing between subparagraphs (D) and (E) of such section, as amended by section 301(a)(2)(C) of the Social Security Amendments of 1983)—

(1) by striking out all that follows "has attained" and precedes ", the first month" in clause (i) and inserting in lieu thereof "retirement age (as defined in section 216(l))"; and

(2) by striking out all that follows "has not attained" and precedes ", or" in clause (ii)(I) and inserting in lieu thereof "retirement age (as defined in section 216(l)".

(b)(1) Section 202(e)(2)(A) of such Act (as amended by section 133(a)(1)(B) of the Social Security Amendments of 1983) is amended by striking out all that follows "subsection

(q)," and precedes "subparagraph (D) of this paragraph" and inserting in lieu thereof "paragraph (7) of this subsection, and".

(2) Section 202(e)(2)(C) of such Act (as amended by section 133(a)(1)(B) of the Social Security Amendments of 1983) is amended—

(A) by striking out the period after "deceased individual"; and

(B) by inserting a closing parenthesis after "paragraph (3) of such subsection (w)".

(3) Paragraph (7) of section 202(e) of such Act (as redesignated by section 131(a)(3)(A) of the Social Security Amendments of 1983) is amended by striking out "paragraph (2)(B)," and inserting in lieu thereof "paragraph (2)(D),".

(c)(1) Section 202 (f)(2)(A) of such Act is amended by striking out "paragraph (3)(B)," and inserting in lieu thereof "paragraph (3)(D),".

(2) Section 202(f)(3)(C) of such Act (as amended by section 133(b)(1)(B) of the Social Security Amendments of 1983) is amended by striking out the period after "deceased individual".

(d) Section 202(q)(9)(B)(i) of such Act (as amended by section 201(b)(1) of the Social Security Amendments of 1983) is amended by striking out "section 216(a)" and inserting in lieu thereof "section 216(l)".

(e) Section 202(x) of such Act (as added by section 339 of the Social Security Amendments of 1983) is amended by inserting in the beginning thereof the following heading:

"Limitation on Payments to Prisoners".

(f)(1) Section 205(r) of such Act (as added by section 336 of the Social Security Amendments of 1983) is amended—

(A) by striking out "(r)(3)(A) and (r)(3)(B)" in paragraph (4) and inserting in lieu thereof "subparagraphs (A) and (B) of paragraph (3)";

(B) by striking out "the Act" in paragraph (7) and inserting in lieu thereof "this Act"; and

(C) by striking out the heading and inserting in lieu thereof the following:

"Use of Death Certificates to Correct Program Information".

(g) Section 209(e) of such Act (as amended by section 324(c)(2) of the Social Security Amendments of 1983) is amended by striking out the first semicolon after "Act of 1974".

(h) Section 210(a)(5)(B) of such Act (as amended by section 101(a)(1) of the Social Security Amendments of 1983) is amended by inserting "performing service which is excluded from the term 'employment' " after "continuously" where it first occurs.

(i)(1) Section 215(a)(7)(B)(ii)(I) of such Act (as added by section 113(a) of the Social Security Amendments of 1983) is amended by striking out "who initially became eligible for old-age or disability insurance benefits" and inserting in lieu thereof "who became eligible (as defined in paragraph (3)(B)) for old-age insurance benefits (or became eligible as so defined for disability insurance benefits before attaining age 62)".

(2) Section 215(i)(5)(A) of such Act (as added by section 112(c) of the Social Security Amendments of 1983) is amended by adding at the end thereof the following new sentence: "Any amount so increased that is not a multiple of $0.10 shall be decreased to the next lower multiple of $0.10.".

(3) Section 215(i)(5)(B) of such Act (as so added) is amended—

(A) by striking out "ending with such subsequent calendar year" in clauses (iv) and (v) and inserting in lieu thereof "ending with the year before such subsequent calendar year"; and

(B) by striking out "initially became eligible for an old-age or disability insurance benefit" in clause (v) and inserting in lieu thereof "became eligible (as defined in subsection (a)(3)(B)) for the old-age or disability insurance benefit that is being increased under this subsection".

(j)(1) Section 216(f) of such Act is amended by adding at the end thereoi the following new sentence: "For purposes of subparagraph (C) of section 202(c)(1), a divorced husband shall be deemed not to be married throughout the month in which he becomes divorced.".

(2) Section 216(h)(3)(A)(i) of such Act (as amended by section 201(c)(1)(D) of the Social Security Amendments of 1983 (after the application of section 402(b)(1) of this Act)) is amended by striking out "(as defined in section 216(l)" and inserting in lieu thereof "(as defined in subsection (l))".

(3) Section 216(i)(2) of such Act (as amended by section 201(c)(1)(D) of the Social Security Amendments of 1983 (after the application of section 402(b)(1) of this Act)) is amended by striking out "(as defined in section 216(l))" in subparagraphs (B) and (D) and inserting in lieu thereof "(as defined in subsection (l))".

(k) Section 229(b) of the Social Security Act (as amended by section 151(b)(1) of the Social Security Amendments of 1983) is amended by adding at the end thereof the following new sentence: "The transfers permitted under this subsection may include adjustments with respect to wages deemed to have been paid in 1983 as determined under section 151(b)(3) of the Social Security Amendments of 1983.".

SEC. 402. AMENDMENTS TO TEXT OF 1983 AMENDMENTS.

(a) Section 112(f) of the Social Security Amendments of 1983 (Public Law 98–21) is amended by inserting "of such Act" after "section 201(a)".

(b) Section 201(c) of such amendments is amended—

(1) by inserting "the" immediately before "age of 65" in paragraph (1); and

(2) by inserting "the" immediately before "age of sixty-five" in paragraph (3).

(c) Section 301(a)(5) of such Amendments is amended by striking out "Section 202(c)" and inserting in lieu thereof "Effective with respect to monthly insurance benefits for months after December 1984 (but only on the basis of applications filed on or after January 1, 1985), section 202(c)".

(d) Section 305(d)(2) of such Amendments is amended by inserting "each place it appears" immediately before "in subsection (c)(4)(C)".

(e) Section 322(a)(1)(B) of such Amendments is amended by striking out "; except" and inserting in lieu thereof "; except".

(f)(1) Section 422A(c)(9) of the Internal Revenue Code of 1954 (relating to special rule when disabled) is amended by striking out "section 105(d)(4)" and inserting in lieu thereof "section 37(e)(3)".

(2)(A) Section 324(d)(1) of the Social Security Amendments of 1983 is amended by adding at the end thereof the

following new sentence: "For purposes of applying such amendments to remuneration paid after December 31, 1983, which would have been taken into account before January 1, 1984, if such amendments had applied to periods before January 1, 1984, such remuneration shall be taken into account when paid.".

(B) Section 324(d)(2) of such amendments is amended by adding at the end thereof the following new sentence: "For purposes of applying such amendments to remuneration paid after December 31, 1984, which would have been taken into account before January 1, 1985, if such amendments had applied to periods before January 1, 1985, such remuneration shall be taken into account when paid.".

(g) Section 327(d) of such amendments (relating to codification of Rowan decision with respect to meals and lodging) is amended to read as follows:

"(d) The amendments made by this section shall apply to remuneration paid after March 4, 1983, and to remuneration paid on or before such date which the employer treated as wages when paid.".

(h) Section 339(b) of such amendments is amended to read as follows:

"(b) Section 223(f) of such Act is amended to read as follows:

" '(f) For provisions relating to limitation on payments to prisoners, see section 202(x).'.".

(i) Section 111(e) of such amendments is amended by inserting "Budget" before "Reconciliation".

SEC. 403. OTHER TECHNICAL CORRECTIONS IN OASDI PROVISIONS.

(a)(1)(A) Section 201(d) of the Social Security Act is amended by striking out "public debt obligation" in the third sentence and inserting in lieu thereof "public debt obligations".

(B) Section 201(g)(1)(B) of such Act is amended by striking out "clauses" in the first sentence and inserting in lieu thereof "clause".

(2)(A) Section 202(d)(1)(G) of such Act is amended—

(i) by striking out the comma after "age of 18";

(ii) by striking out ", or, subject" and inserting in lieu thereof "subject";

(iii) by striking out "(and for purposes" and inserting in lieu thereof "; and for purposes"; and

(iv) by striking out the semicolon before "except that".

(B) Section 202(e)(1) of such Act is amended—

(i) by striking out the first comma after "age 60" in the matter following subparagraph (F)(ii); and

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(ii) by striking out "he engages" in the last sentence and inserting in lieu thereof "she engages".

(C) Section 202(f)(1) of such Act is amended by striking out the first comma after "age 60" in the matter following subparagraph (F)(ii).

(D) Section 202(f)(3)(D)(i) of such Act is amended by striking out the semicolon after "applicable,".

(E) Section 202(q)(7)(E) of such Act is amended by striking out "he attained retirement age" and inserting in lieu thereof "she or he attained retirement age".

(F) Section 202(t)(4)(E) of such Act is amended—

(i) by inserting "of 1937 or 1974" after "Railroad Retirement Act" where it first appears; and

(ii) by inserting before the semicolon at the end thereof the following: "of 1937 or section 18(2) of the Railroad Retirement Act of 1974".

(3)(A) Section 203(d)(2) of such Act is amended by striking out "an individual who is entitled" and inserting in lieu thereof "an individual under the age of seventy who is entitled".

(B) Section 203(f)(5)(B)(ii) of such Act is amended by striking out "702(a)(9)" and inserting in lieu thereof "702(a)(8)".

(4)(A) Section 205(c)(5)(C) of such Act is amended by inserting "of 1937 or 1974" after "Railroad Retirement Act" each place it appears.

(B) Section 205(c)(5)(I) of such Act is amended by inserting before the semicolon at the end thereof the following: "or section 7(b)(7) of the Railroad Retirement Act of 1974".

(C) Section 205(e) of such Act is amended by striking out "on order" and inserting in lieu thereof "an order".

(D) Section 205(h) of such Act is amended by striking out "Section 24 of the Judicial Code of the United States" and inserting in lieu thereof "section 1331 or 1346 of title 28, United States Code,".

(E) Section 205(p)(1) of such Act is amended by striking out "section 1420(e) of the Internal Revenue Code" and inserting in lieu thereof "section 3122 of the Internal Revenue Code of 1954".

(5)(A) Section 209 of such Act is mended—

(i) by striking out "(p) Remuneration" and inserting in lieu thereof "(p)(1) Remuneration";

(ii) by striking out the period at the end of paragraph (p)(1) as redesignated by subparagraph (A) of this paragraph and inserting in lieu thereof a semicolon; and

(iii) by striking out "(p) Any contribution" and inserting in lieu thereof "(2) Any contribution".

(B) The seventh paragraph from the end of section 209 of such Act (relating to remuneration for service performed as a member of a uniformed service) is amended by striking out "section 102(10) of the Servicemen's and Veterans' Survivor Benefits Act" and inserting in lieu thereof "chapter 3 and section 1009 of title 37, United States Code".

(6)(A) Section 210(a)(1) of such Act is amended by striking out "(A)" and all that follows down through "or (B)".

(B) Section 210(a)(9) of such Act is amended by striking out "section 1532 of the Internal Revenue Code" and inserting in lieu thereof "section 3231 of the Internal Revenue Code of 1954".

(C) Section 210(a)(19) of such Act is amended by striking out the comma after "; or".

(D) Section 210(l)(2) of such Act is amended—

(i) by striking out "section 102 of the Servicemen's and Veterans' Survivor Benefits Act" and inserting in lieu thereof "paragraph (21) of section 101 of title 38, United States Code"; and

(ii) by striking out "such section" and inserting in lieu thereof "paragraph (22) of such section".

(E) Section 210(l)(3) of such Act is amended by striking out "such section 102" and inserting in lieu thereof "paragraph (23) of such section 101".

(F) Section 210(m) of such Act is amended—

(i) by striking out "section 102(3) of the Servicemen's and Veterans' Survival Benefits Act" in the first sentence and inserting in lieu thereof "section 101(27) of title 38, United States Code";

(ii) by striking out "military or naval" each place it appears in paragraph (5) and inserting in lieu thereof "military, naval, or air"; and

(iii) by striking out "Universal Military Training and Service Act" in paragraph (5)(B) and inserting in lieu thereof "Military Selective Service Act".

(7)(A) Section 211(a) of such Act is amended by striking out "chapter 1 of the Internal Revenue Code" and "section 183 of such code" in the matter preceding paragraph (1) and inserting in lieu thereof "subtitle A of the Internal Revenue Code of 1954" and "section 702(a)(8) of such Code", respectively.

(B) Section 211(a)(3) of such Act is amended—

(i) by striking out "chapter 1 of the Internal Revenue Code" and inserting in lieu thereof "subtitle A of the Internal Revenue Code of 1954"; and

(ii) by inserting "or" before "(C)".

(C) Section 211(a)(4) of such Act is amended by striking out "section 23(s) of such code" and inserting in lieu thereof "section 172 of the Internal Revenue Code of 1954".

(D) Section 211(a) of such Act is further amended by striking out "702(a)(9)" in clauses (iii) and (iv) (in the matter following paragraph (12)) and inserting in lieu thereof in each instance "702(a)(8)".

(E) Section 211(c) of such Act is amended by striking out "section 23 of the Internal Revenue Code" and inserting in lieu thereof "section 162 of the Internal Revenue Code of 1954".

(F) Section 211(c)(3) of such Act is amended by striking out "section 1532 of the Internal Revenue Code" and inserting in lieu thereof "section 3231 of the Internal Revenue Code of 1954".

(G) Section 211(d) of such Act is amended by striking out "supplement F of chapter 1 of the Internal Revenue Code" and inserting in lieu thereof "subchapter K of chapter 1 of the Internal Revenue Code of 1954".

(H) Section 211(e) of such Act is amended by striking out "chapter 1 of the Internal Revenue Code", "chapter 1 of such code", and "such chapter 1" and inserting in lieu thereof "subtitle A of the Internal Revenue Code of 1954", "subtitle A of such Code", and "such subtitle A", respectively.

(8) Section 213(a)(1) of such Act is amended by striking out "means" and inserting in lieu thereof "mean".

(9)(A) Section 215(a)(1) of such Act is amended—

(i) by striking out "of such benefits" in subparagraph (B)(i) and inserting in lieu thereof "for such benefits";

(ii) by striking out "amounts" in subparagraph (B)(iii) and inserting in lieu thereof "amount"; and

(iii) by striking out "section 217" in subparagraph (C)(ii) and inserting in lieu thereof "section 217".

(B) Section 215(a)(4) of such Act is amended by indenting subparagraph (B) two ems so as to align its left margin with that of subparagraph (A) (and by appropriately further indenting clauses (i) and (ii) of such subparagraph (B)).

(C) Section 215 (f)(2)(A) of such Act is amended by striking out "primary insurance account" and inserting in lieu thereof "primary insurance amount".

(10)(A) Section 2203(d)(4) of Public Law 97–35 is amended by inserting after "at the end of paragraph (3)" the following: "(after and below subparagraph (C)(ii))".

(B) Section 216(i)(2)(F)(ii) of the Social Security Act is amended by strikig out "enacted," in the matter immediately preceding subdivision (I) and inserting in lieu thereof "enacted—".

(11) Section 218(i) of such Act is amended by striking out "subchapter A or E of chapter 9 of the Internal Revenue Code" and inserting in lieu thereof "chapter 21 and subtitle F of the Internal Revenue Code of 1954".

(12)(A) The following provisions of title II of such Act are amended by striking out "Health, Education, and Welfare" wherever it appears and inserting in lieu thereof "Health and Human Services":

(i) Subsections (a)(3), (a)(4), (b)(1), (b)(2), (g)(1), (g)(2), (g)(4), and (i)(1) of section 201.

(ii) Subsection (1) of section 205.

(iii) Subsections (q)(4)(B), (q)(6)(B), and (r)(1) of section 218.

(B) The following provisions of title II of such Act are amended by striking out "Health, Education, and Welfare" wherever it appears:

(i) Subsections (a)(10)(B) and (l)(4)(A) of section 210.

(ii) Subsections (a)(2), (a)(3), (b)(2), (b)(3), (e)(3), and (f)(1) of section 217.

(iii) Subsections (a)(1), (c)(4), (d)(3), (d)(7), (h)(3), (i), (j), (k)(1), (l), and (p)(2) of section 218.

(iv) Subsection (g) of section 228.

(v) Subsections (b)(3) and (b)(4) of section 231.

(b)(1)(A) Section 402(a)(9) of such Act is amended by striking out "use of disclosure" and inserting in lieu thereof "use or disclosure".

(B) Section 402(a) of such Act is further amended—

(i) by striking out "must" immediately before the first of its 37 numbered subdivisions and inserting in lieu thereof "must—";

(ii) by identing and aligning such numbered subdivisions (without altering any of the numbering, language, or punctuation) to the extent necessary to make each of such subdivisions a numbered paragraph with its left margin indented two ems (and with any designated internal subdivisions within such paragraphs (other than those in paragraphs (9), (10), (15), (25), (30), (31), (33), and (36)) being appropriately further indented and aligned as subparagraphs or clauses);

(iii) by striking out "and" after the semicolon at the end of paragraph (5);

(iv) by striking out "clause" each place it appears in paragraphs (15)(A), (15)(B), and (19)(F) and inserting in lieu thereof "paragraph"; and

(v) by striking out "section 402(a)(7)" in paragraph (19)(D) and inserting in lieu thereof "paragraph (7)".

(2) Clause (ii) in the last sentence of section 403(j) of such Act is amended by striking out the comma after "excess payments".

(3) Section 441 of such Act is amended by striking out "(a)".

(4) The second sentence of section 452(c)(2) of such Act is amended by striking out "preceding section" and inserting in lieu thereof "preceding sentence".

(5) Section 453(b)(2) of such Act is amended by striking out ", or the United States" and inserting in lieu thereof "of the United States".

(6) Section 454(9)(C) of such Act is amended by striking out "of such parent".

(7) The heading of section 458 of such Act is amended by striking out "STATES" and inserting in lieu in lieu thereof "STATES".

(8) Section 462(f)(2) of such Act is amended by striking out "dependents" and inserting in lieu thereof "dependents' ".

(9)(A) Section 474(b)(4)(A) of such Act is amended by striking out "subparagraph (c)" and inserting in lieu thereof "subparagraph (C)".

(B) Section 474(c)(2) of such Act is amended by striking out "relvant" and inserting in lieu thereof "relevant".

(C) Section 474(d)(1) of such Act is amended—

(i) by striking out "and (c)" and inserting in lieu thereof "and (C)"; and

(ii) by striking out "secretary" and inserting in lieu thereof "Secretary".

(c)(1) Section 1107(b) of such Act is amended—

(A) by striking out "he" each place it appears and inserting in lieu thereof "he or she"; and

(B) by striking out "former wife divorced" and inserting in lieu thereof "divorced spouse".

(2) Section 1110(a)(2) of such Act is amended by striking out "their design" and inserting in lieu thereof "its design".

(3) Section 1131(a)(2)(B) of such Act is amended by striking out the period after "section 204(d) of this Act" and inserting in lieu thereof a comma.

(d)(1) Section 1611(g) of such Act is amended by striking out "or individuals" and inserting in lieu thereof "or such individual".

(2) Section 1612(b)(2) of such Act is amended by indenting subparagraph (B) two ems so as to align its left margin with that of subparagraph (A).

(3) The heading of section 1613(c) of such Act is amended to read as follows:

"Disposal of Resources for Less Than Fair Market Value".

(4) Section 1621(e) of such Act is amended by striking out "severably" and inserting in lieu thereof "severally".

(5) Section 1631(d)(1) of such Act is amended by striking out "(e), and (f)" and inserting in lieu thereof "and (e)".

(e)(1)(A) Section 3121(b)(1) of the Internal Revenue Code of 1954 is amended by striking out "(A)" and all that follows down through "or (B)".

(B) Section 3121(b)(5)(B) of such Code (as amended by section 101(a)(2) of the Social Security Amendments of 1983) is amended by inserting "performing service which is excluded from the term 'employment' " after "continuously" where it first occurs.

(C) Section 3121(i)(2) of such Code is amended by striking out "section 102(10) of the Servicemen's and Veterans' Survivor Benefits Act" and inserting in lieu thereof "chapter 3 and section 1009 of title 37, United States Code".

(D) Section 3121(m)(2) of such Code is amended—

(i) by striking out "section 102 of the Servicemen's and Veterans' Survivor Benefits Act" and inserting in lieu thereof "paragraph (21) of section 101 of title 38, United States Code"; and

(ii) by striking out "such section" and inserting in lieu thereof "paragraph (22) of such section".

(E) Section 3121(m)(3) of such Code is amended by striking out "such section 102" and inserting in lieu thereof "paragraph (23) of such section 101".

(F) Section 3121(n) of such Code is amended—

(i) by striking out "section 102(3) of the Servicemen's and Veterans' Survivor Benefits Act" in the

first sentence and inserting in lieu thereof "section 101(27) of title 38, United States Code";

(ii) by striking out "military or naval" each place it appears in paragraph (5) and inserting in lieu thereof "military, naval, or air"; and

(iii) by striking out "Universal Military Training and Service Act" in paragraph (5)(B) and inserting in lieu thereof "Military Selective Service Act".

(2) The following provisions of such Code are amended by striking out "Health, Education, and Welfare" each place it appears and inserting in lieu thereof "Health and Human Services";

(A) Subsections (c)(1), (g)(1), (g)(3)(A), and (g)(3)(B) of section 1402.

(B) Subsection (b)(10)(B) of section 3121.

SEC. 404. EFFECTIVE DATES.

(a) The amendments made by sections 401 and 402 shall be effective as though they had been included in the enactment of the Social Security Amendments of 1983 (Public Law 98–21).

(b)(1) Except to the extent otherwise specifically provided in this title, the amendments made by section 403 shall be effective on the date of the enactment of this Act; but none of such amendments shall be construed as changing or affecting any right, liability, status, or interpretation which

existed (under the provisions of law involved) before that date.

Subtitle B—Changes in Medicare-Related Provisions

SEC. 411. MEDICARE CORRECTIONS RELATING TO THE SOCIAL SECURITY AMENDMENTS OF 1983.

(a)(1) Section 1866(a)(1)(F) of the Social Security Act is amended by inserting "with a professional standards review organization (if there is such an organization in existence in the area in which the hospital is located as of July 1, 1983) or" before "a utilization and quality control".

(2) The amendment made by paragraph (1) shall take effect on January 1, 1984.

(b)(1) Section 1886(d)(1) of such Act is amended—

(A) by striking out ", or discharges occurring" in subparagraph (C), and

(B) by striking out "cost reporting periods beginning, or" in subparagraph (D).

(2) Section 1886(c)(4)(A) of such Act is amended by striking out "and (D)" and inserting in lieu thereof "(D) and (E)".

(3) Section 1886(e)(5) of such Act is amended—

(A) by striking out "for public comment" in the matter before subparagraph (A), and

(B) by inserting "for public comment" in subparagraph (A) after "that fiscal year,".

(4) Section 1866(A)(1)(F) of such Act, as added by section 602(f)(1)(C) of the Social Security Amendments of 1983, is amended by striking out "(c) or (d)" and inserting in lieu thereof "(b), (c), or (d)".

(5)(A) The last sentence of section 1878(f)(1) of such Act is amended by inserting "or which have obtained a hearing under subsection (b)" after "common ownership or control".

(B) The amendment made by subparagraph (A) shall be effective with respect to any appeal or action brought on or after the date of the enactment of this Act.

(6) Section 1818(c) of such Act is amended by striking out "subsection (a) of section 1839" and inserting in lieu thereof "subsection (b) of section 1839".

(c)(1) Section 1817(a) of the Social Security Act, as amended by section 141(b) of the Social Security Amendments of 1983, is amended--

(A) by striking out "monthly on the first day of each calendar month" in the next to last sentence and inserting in lieu thereof "from time to time",

(B) by striking out "to be paid to or deposited into the Treasury during such month" in such sentence

and inserting in lieu thereof "paid to or deposited into the Treasury", and

(C) by striking out the last sentence.

(2) The amendments made by paragraph (1) shall become effective on the first day of the month following the month in which this Act is enacted.

(d)(1) Section 602(h)(2) of the Social Security Amendments of 1983 (Public Law 98–21) is amended by adding at the end the following new subparagraph:

"(C) Notwithstanding section 604(a)(1), the amendments made by this paragraph shall be effective with respect to any appeal or action brought on or after the date of the enactment of this Act.".

(2) Section 604(c)(3) of such Act is amended by striking out "to implement subsection (d) of section 1886 of the Social Security Act (as so amended)" and inserting in lieu thereof "to implement the amendments made by this title".

(e) Except as otherwise specifically provided in this section, the amendments made by this section shall be effective as though they had been included in the enactment of the Social Security Amendments of 1983 (Public Law 98–21).

SEC. 412. ENROLLMENT AND PREMIUM PENALTY WITH RESPECT TO WORKING AGED PROVISION.

(a) The second sentence of section 1839(b) of the Social Security Act is amended by adding before the period at the

end the following: ", but there shall not be taken into account months in which the individual has attained the age of 65 (but not attained the age of 70) and can demonstrate that the individual was enrolled in a group health plan described in section 1862(b)(3)(A)(iv) by reason of the individual's (or the individual's spouse's) current employment".

(b) Section 1837 of such Act is amended by adding at the end the following new subsection:

"(i)(1) In the case of an individual who—

"(A) has attained the age of 65, but has not attained the age of 70,

"(B) at the time the individual first satisfies paragraph (1) or (2) of section 1836, is enrolled in a group health plan described in section 1862(b)(3)(A)(iv) by reason of the individual's (or the individual's spouse's) current employment, and

"(C) has elected not to enroll (or to be deemed enrolled) under this section during the individual's initial enrollment period,

there shall be a special enrollment period described in paragraph (3).

"(2) In the case of an individual who—

"(A) has attained the age of 65, but has not attained the age of 70,

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"(B)(i) has enrolled (or has been deemed to have enrolled) in the medical insurance program established under this part during the individual's initial enrollment period and any subsequent special enrollment period under this subsection during which the individual was not enrolled in a group health plan described in section 1862(b)(3)(A)(iv) by reason of the individual's (or individual's spouse's) current employment, and

"(C) the individual has not terminated enrollment under this section at any time at which the individual is not enrolled in such a group health plan by reason of the individual's (or individual's spouse's) current employment,

there shall be a special enrollment period described in paragraph (3).

"(3) The special enrollment period referred to in paragraphs (1) and (2) is the period—

"(A) beginning with the first day of the third month before the month in which the individual attains the age of 70 and ending 7 months later, or

"(B) beginning with the first day of the first month in which the individual is no longer enrolled in a group health plan described in section 1862(b)(3)(A)(iv) by reason of current employment and ending 4 months later,

whichever period begins earlier.".

(c) Section 1838 of such Act is amended by adding at the end the following new subsection:

"(e) Notwithstanding subsection (a), in the case of an individual who enrolls during a special enrollment period pursuant to—

"(1) subparagraph (A) of section 1837(i)(3)—

"(A) before the month in which he attains the age of 70, the coverage period shall begin on the first day of the month in which he has attained the age of 70,

"(B) in the month in which he attains the age of 70, the coverage period shall begin on the first day of the month following the month in which he so enrolls, or

"(C) in a month after the month in which he attains the age of 70, the coverage period shall begin on the first day of the second month following the month in which he so enrolls; or

"(2) subparagraph (B) of section 1837(i)(3)—

"(A) in the first month of the special enrollment period, the coverage period shall begin on the first day of such month, or

"(B) in a month after the first month of the special enrollment period, the coverage period

shall begin on the first day of the month following the month in which he so enrolls.".

(d)(1) The amendment made by subsection (a) shall apply to months beginning on or after January 1983 for premiums for months beginning with the first effective month (as defined in paragraph (3)).

(2) The amendments made by subsections (b) and (c) shall apply to enrollments in months beginning with the first effective month, except that in the case of any individual who would have had a special enrollment period under section 1837(i) of the Social Security Act that would have begun before such first effective month, such period shall be deemed to begin with the first day of such first effective month.

(3) For purposes of this subsection, the term "first effective month" means the first month which begins more than 60 days after the date of the enactment of this Act.

SEC. 413. MISCELLANEOUS CORRECTIONS.

(a)(1) The last sentence of section 1814(a) of the Social Security Act and the last sentence of section 1835(a) of such Act are each amended by striking out "contractural" and insert in lieu thereof "contractual".

(2) Section 1866(a)(1)(E) of such Act is amended by adding at the end a comma.

(3) Section 1876(b)(2)(D) of such Act is amended by striking out "paragraph (1)" and inserting in lieu thereof "subparagraph (A)".

(b) Section 162(i)(2) of the Internal Revenue Code of 1954 is amended by striking out "213(e)" and inserting in lieu thereof "213(d)".

Mrs. KENNELLY. I take this opportunity to call the Committee on Ways and Means to order.

The committee will hold hearings today on H.R. 3805, Technical Corrections Act of 1983. The bill will make technical corrections to the Tax Equity and Fiscal Responsibility Act of 1982, the Subchapter S Revision Act of 1982, the Highway Revenue Act of 1982, the social security amendments, and related legislation.

Chairman Rostenkowski has asked me to express his appreciation for the cooperation of the Treasury Department, the Social Security Administration, and the Health Care Financing Administration for preparing this legislation, and the helpful comments received from the American Bar Association, the American Institute of Certified Public Accountants, and other professional groups, and individuals.

I wish to emphasize that the scope of these hearings will be strictly limited to technical amendments and that the committee will not receive testimony which proposes substantive or unrelated policy changes.

We are very pleased this morning that our first witness is Hon. Bill Frenzel.

STATEMENT OF HON. BILL FRENZEL, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MINNESOTA

Mr. FRENZEL. Thank you very much, Madam Chairwoman. I ask unanimous consent that my prepared statement may be made a part of the record and that I might proceed for a few minutes.

Mrs. KENNELLY. Certainly.

Mr. FRENZEL. Madam Chairwoman, the point that I would like to make today on H.R. 3805, the Technical Corrections Act of 1983, refers to title III of the bill dealing with amendments of the Highway Revenue Act of 1982. The point that I want to make may be a little heavy for a technical correction, but I think it is something that ought to be brought to the attention of the committee.

When we passed that bill we increased the user tax for trucks from a maximum of $240 to a maximum of $1,900, something like an 800-percent increase. Most of us on the committee have heard from a number of organizations who not only were not enthusiastic about the bill itself but were particularly opposed to the increase in the user tax and the very large yearly amount of money that had to be paid at one time.

The bill which I, and Congressman Jenkins, and Congressman Campbell have introduced, H.R. 2124, tries to get at that problem in a revenue-neutral way by replacing that use tax with a diesel oil tax, and there are 16 members of this committee who are currently sponsors and about 195 Members of the House who are also sponsors.

The bill is flawed in that there is not enough revenue in it to make it neutral. It is our intention to make it neutral. And, therefore, although it is not strictly a technical correction and the committee may want to handle it at a later time in some other way, I do want to say, Madam Chairman, that somewhere in the next 45 days this committee and its counterpart in the Senate are going to be confronted with some sort of tax legislation, perhaps a bill as

large as would satisfy the budget resolution, perhaps one of more modest scope.

This particular bill, H.R. 2124, of which you are one of the prominent cosponsors, is a way in which the committee might be able to make whatever package comes forth considerably more attractive since it is a revenue-neutral bill which enjoys the support of a large number of our colleagues throughout the House.

I hope that the committee will take this testimony and that bill into consideration as it goes about its work of the next 7 weeks, including the Technical Corrections Act.

Madam Chairman, I thank you for indulging me and would be pleased to respond to any questions.

[The prepared statement follows:]

STATEMENT OF HON. BILL FRENZEL, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MINNESOTA

Mr. Chairman and Members of the Committee, thank you for providing me with this opportunity to testify today on H.R. 3805, the Technical Corrections Act of 1983. I am here today specifically to address my colleagues on Title III of the bill, dealing with amendments to the Highway Revenue Act of 1982.

In general, I think that the staff has done a good job in correcting flaws and clarifying the provisions in the original Highway Revenue Act. I strongly feel, however, that while we are making corrections in the Highway Revenue Act, we should do the job right, and change the method by which the revenues for the Highway Trust Fund are collected by shifting the method of taxation from a per vehicle truck use tax to a per gallon tax on diesel fuel used by trucks.

In 1982, the main issue before this Committee was not how the increase in truck taxes was going to be structured, but rather how much of an increase was going to be imposed on the trucking industry. Consequently, the general issue as to the inequities inherent in the heavy vehicle use tax was never considered.

Since the enactment of the increase in the heavy vehicle use tax, I have heard from what seems at times to be every trucker in the country. Generally, while they still think the Department of Transportation allocation study was flawed, and that trucks are being assigned too large a proportion of the cost of maintaining our highway network, the majority of truckers appear to be resigned to paying a much larger share of the cost of our highway system. What they are adamantly opposed to, however, is the unfair method by which the tax is collected.

The current heavy vehicle use tax is indeed an unfair and inequitable method of taxation. It requires the trucker who travels short distances, such as 15,000 miles per year, entirely within one city, who rarely uses the interstate system, to pay the same amount of heavy vehicle use tax as the long haul trucker who may travel 200,000 miles per year, almost exclusively on the interstate system. It requires the small trucker, who may keep one or two trucks in reserve, to pay the heavy vehicle use tax on those trucks in order to have them available to handle occasional overflow business. Worst of all, the heavy vehicle use tax requires a trucker to pay the tax whether he or she is working at all. If a trucker was clairvoyant, and could tell at the beginning of the year whether or not there would be sufficient work to justify paying the tax, this would not be a problem. However, with the advent of deregulation, coupled with the recent recession, there has been day-to-day uncertainty as to whether many smaller, independent truckers would be rolling.

It is true that these same problems with the heavy vehicle use tax existed before the enactment of the Highway Revenue Act. However, problems which are tolerable at a maximum tax rate of $240 per year can completely destroy a business at a maximum level of $1,900 per year.

In order to resolve the problems inherent in the Highway Revenue Act of 1982, I, along with Mr. Jenkins and Mr. Campbell, introduced H.R. 2124. We have been joined by 13 of our colleagues on this Committee and 195 of our colleagues in the House. An identical bill has been introduced in the Senate by Senator Wallop and several other Finance Committee Members.

Generally, H.R. 2124 would repeal the entire heavy vehicle use tax and replace it with a tax based solely on the consumption of diesel fuel by trucks with a gross vehicle weight rating of more than 10,000 pounds. The bill calls for an increase in the

diesel fuel excise tax of 5¢ per gallon, from 9¢ to 14¢. Cars and light trucks would be exempt from this increase.

It was, and always has been, our intention to provide a revenue neutral substitute for the heavy vehicle use tax as amended by the 1982 Highway Revenue Act. When the issue is brought before the Committee in a mark-up, we intend to increase the diesel fuel tax a sufficient amount to make the proposal revenue neutral. As I currently understand it, this would require a total increase in the diesel fuel tax of approximately 7¢.

Mr. Chairman, it has been almost a year since the Highway Revenue Act was enacted. What was once a distant effective date for the increase in the heavy vehicle use tax is rapidly approaching. H.R. 2124, as it will be amended, represents an alternative to the heavy vehicle use tax that will be revenue neutral, and that has the support of the overwhelming majority of the trucking industry.

There has been more than enough of a delay in bringing the reconsideration of this matter before the Committee. The Congress should move swiftly and firmly towards resolving the matter once and for all. If DOT wants to propose an alternative, it should do so now. If not, Congress should act anyway.

Within the next several weeks, the Committee will apparently be considering several different tax proposals. Many of these proposals, while necessary, could prove to be very unpopular. In H.R. 2124 we have the opportunity to enact a provision that not only is very popular among the taxpayers affected by its provisions, but is also revenue neutral.

I urge the Committee to include a revision of the heavy vehicle use tax in the mark up of H.R. 3805.

Thank you.

Mrs. KENNELLY. Thank you, Mr. Frenzel.

Mr. Duncan.

Mr. DUNCAN. I have no particular questions other than to commend my colleague for bringing this to our attention. I think it has been a problem for all of the members of the committee.

All of us have been contacted about the problem that exists. I want to thank you, Bill, for amplifying.

Mr. FRENZEL. Thank you.

Mrs. KENNELLY. Mr. Campbell.

Mr. CAMPBELL. Thank you, Madam Chairman.

I want to commend the gentleman also for bringing this before the committee. I believe I heard him say that there are 195 cosponsors on this legislation. Is that correct?

Mr. FRENZEL. That is correct, Mr. Campbell.

Mr. CAMPBELL. And the bill is aimed to be revenue neutral, and with some minor corrections, it can be revenue neutral. It is aimed at correcting what seems to be a major problem in the trucking industry without losing the tax, but by having a fair distribution of that tax; is that correct?

Mr. FRENZEL. That is the intention.

Mr. CAMPBELL. Well, I certainly commend the gentleman for bringing this before us and I should hope that the Ways and Means Committee will see fit to include this in any tax legislation.

I think that it would, in fact, greatly enhance the possibility of passage of any bill because of the injustices that seem to have been done by the tax that was levied on the heavy-user fee. I certainly intend to support such an effort.

Mr. FRENZEL. Thank you, Mr. Campbell. It has 195 sponsors but none are more important than you.

Mrs. KENNELLY. I, too, Mr. Frenzel, want to thank you for sponsoring this bill because each of us who sit here now understand the concern the truckers have had and the way they have tried to go about bringing this to our attention in a responsible way.

I thank you for spearheading it because I think change is a necessity. The Surface Transportion Act had so many good elements in it, it probably was inevitable that something needed to be corrected. I thank you for trying to correct it.

Mr. FRENZEL. Thank you very much, Madam Chairman.

Mrs. KENNELLY. The next witness will be the U.S. Department of the Treasury, Mikel Rollyson, deputy legislative counsel.

STATEMENT OF MIKEL M. ROLLYSON, DEPUTY TAX LEGISLATIVE COUNSEL, DEPARTMENT OF THE TREASURY

Mr. ROLLYSON. Good morning, Madam Chairman and members of the committee. I am pleased to present the views of the Treasury Department on H.R. 3805, the Technical Corrections Act of 1983.

This bill makes technical revisions to the Tax Equity and Fiscal Responsibility Act of 1982 [TEFRA], the Subchapter S Revision Act of 1982, the Highway Revenue Act of 1982, the Social Security Amendments of 1983, and other recently enacted legislation.

With one exception, we believe the bill makes only changes that are technical in nature. That is, changes that are necessary to clarify and conform the language of the Internal Revenue Code to the congressional intent in enacting these acts.

The one nontechnical provision of the bill, section 411(a), alters the funding mechanism for professional standards review organizations. This provision concerns the medicare program and, therefore, the Department of Health and Human Services will submit to the committee its views on this provision.

The Treasury Department strongly supports enactment of H.R. 3805. The bill is essential to the successful implementation of the major tax legislation that has been enacted by the Congress over the past 13 months.

H.R. 3805 is based on a technical review of the acts described above by the staffs of your committee and the Joint Committee on Taxation, with the assistance of the staffs of the Treasury Department, the Social Security Administration and the Health Care Financing Administration. Comments from professional groups, individual tax practitioners and other interested parties were considered in this process.

I would like to take this opportunity to compliment the staff of the Joint Committee on Taxation which has coordinated this review in its usual outstanding fashion.

Since the provisions of the bill, which number in excess of 50, are well summarized in the Joint Committee staff pamphlet, extended discussion on my part is not necessary. I would, however, like to touch generally on a few areas covered by this legislation.

The bill makes several changes to the corporate tax provisions that were added or amended by TEFRA. Of particular importance are the amendments to section 338, which in certain circumstances electively allows a purchase of 80 percent or more of a corporation's stock to be treated as a purchase of the corporation's assets.

Among other things, the bill would clarify certain aspects of the rules for determining the purchasing corporation's basis in the assets of the acquired corporation when a section 338 election is made. These provisions of the bill are intended to carry out the

intent of the TEFRA legislation, and we strongly support these changes.

Nevertheless, some of the provisions introduced by TEFRA are extremely complex, and there may be differing views on how the intent of the Congress can best be effectuated. As we continue to study these provisions, it may be necessary to suggest additional amendments to carry out adequately that congressional intent.

In this regard, I would like to bring to the attention of the committee the thoughtful statement of Mr. Martin D. Ginsburg, which will be submitted to the committee for consideration.

H.R. 3805 makes several other changes to the SSA which we support. In addition, there are two significant issues which are not included in H.R. 3805 which we believe should be incorporated in the list of technical corrections. These are described in the written submission which we give to the committee.

We fully support these changes and moreover we expect that other necessary technical amendments will be suggested as these proposals are reviewed and discussed by the interested parties. We look forward to working with the members of your committee in developing these proposals.

Finally, it should be noted that the provisions in the bill are generally effective retroactive to the effective date of the corrected legislation. As a general rule, these retroactive effective dates are appropriate.

However, there may be instances in which retroactivity operates harshly and unfairly to affected taxpayers. We believe that the possibility of prospective effective dates for certain provisions should be considered in appropriate situations.

That concludes my formal statement and I would be happy to answer any questions the committee may have.

Mrs. KENNELLY. Thank you, Mr. Rollyson. The committee welcomes your support and thanks you for your testimony.

Are there any questions?

Thank you very much.

[The prepared statement follows:]

STATEMENT OF MIKEL M. ROLLYSON, DEPUTY TAX LEGISLATIVE COUNSEL, DEPARTMENT OF THE TREASURY

Mr. Chairman and Members of the Committee, I am pleased to present the views of the Treasury Department on H.R. 3805, the Technical Corrections Act of 1983. This bill makes technical revisions to the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"), the Subchapter S Revision Act of 1982, the Highway Revenue Act of 1982, the Social Security Amendments of 1983, and other recently enacted legislation. With one exception, we believe the bill makes only changes that are technical in nature. That is, changes that are necessary to clarify and conform the language of the Internal Revenue Code to the Congressional intent in enacting these acts. The one non-technical provision of the bill, section 411(a), alters the funding mechanism for Professional Standards Review Organizations. This nontechnical provision concerns the Medicare program and, therefore, the Department of Health and Human Services will submit to the Committee its views on this provision.

The Treasury Department strongly supports enactment of H.R. 3805. The bill is essential to the successful implementation of the major tax legislation that has been enacted by the Congress over the past 13 months.

BACKGROUND

H.R. 3805 is based on a technical review of the acts described above by the staffs of your Committee and the Joint Committee on Taxation, with the assistance of the

staffs of the Treasury Department, the Social Security Administration and the Health Care Financing Administration. Comments from professional groups, individual tax practitioners and other interested parties were considered in this process. I would like to take this opportunity to compliment the staff of the Joint Committee on Taxation which has coordinated this review in its usual outstanding fashion.

Since the provisions of the bill, which number in excess of fifty, are well summarized in the Joint Committee staff pamphlet, extended discussion on my part is not necessary. I would, however, like to touch generally on a few areas covered by this legislation.

TEFRA TECHNICAL CORRECTIONS (TITLE I OF H.R. 3805)

The bill makes several changes to the corporate tax provisions that were added or amended by TEFRA. Of particular importance are the amendments to section 338, which in certain circumstances electively allows a purchase of 80 percent or more of a corporation's stock to be treated as a purchase of the corporation's assets. Among other things, the bill would clarify certain aspects of the rules for determining the purchasing corporation's basis in the assets of the acquired corporation when a section 338 election is made. These provisions of the bill are intended to carry out the intent of the TEFRA legislation, and we strongly support these changes.

Nevertheless, some of the provisions introduced by TEFRA are extremely complex, and there may be differing views on how the intent of the Congress can best be effectuated. As we continue to study these provisions, it may be necessary to suggest additional amendments to carry out adequately that congressional intent.

TECHNICAL CORRECTIONS TO THE SOCIAL SECURITY AMENDMENTS OF 1983 (TITLE IV OF H.R. 3805)

The bill clarifies the tax treatment of nonqualified deferred compensation paid after December 31, 1983, under an agreement entered into after March 24, 1983, for pre-1984 services for which there is no substantial risk of forfeiture in 1983. Under the Social Security Amendments of 1983 (the "SSA"), amounts paid under such an agreement would have been included in the FICA and FUTA basis in 1983, had the SSA applied to periods before January 1, 1984. H.R. 3805 solves this ambiguity in the tax treatment of these amounts by providing that they shall be taken into account when paid.

We agree that a solution is needed to this technical oversight in the transition rules governing nonqualified deferred compensation. However, we do not believe that the technical correction should mandate that these amounts be taken into account when paid. Such a rule would create unnecessary complications for employers and administrators of deferred compensation plans, who would be required under this proposed change to analyze post-1983 payouts under three separate rules, i.e, (1) those applicable prior to the enactment of the SSA (for payouts grandfathered under the SSA); (2) the "tax at time of deferral" rule (for payouts for post-1983 services); and (3) the "tax when paid" rule (for payouts under post-March 24, 1983 agreements for pre-1984 services).

A better solution to this problem would be to offer employers the option of including in the FICA and FUTA bases at the time of deferral any amounts deferred under a post-March 24, 1983 agreement. This change would ensure that post-1983 payouts of deferred compensation would be subject to only the first two rules outlined above.

H.R. 3805 makes several other changes to the SSA which we support. In addition, there are two significant issues which are not included in H.R. 3805 which we believe should be incorporated in the list of technical corrections.

The first issue involves an amendment made by section 324 of the SSA, which provides that amounts treated by Code section 414(h) as employer contributions to state or local government "pick-up" plans will be included in the wage base when deferred. This provision was intended merely to codify present law and administrative practice within the Social Security Administration. Under these present practices, the Social Security Administration includes only elective employee contributions to State pick-up plans in the tax and benefit base. However, due to a drafting error, both nondiscretionary and elective plan contributions are brought into the tax and benefits base by section 324 of the SSA. A technical correction is needed to prevent the coverage of nondiscretionary pick-up contributions for tax and benefit purposes.

The second issue concerns the broadening of the prohibition against assignment of social security benefits made by section 335 of the SSA. The SSA added a provision aimed specifically at prohibiting the assignment of benefits in bankruptcy cases. It

appears that this provision, as drafted, inadvertently repealed the IRS's authority to collect delinquent taxes from social security payments in cases of flagrant tax avoidance where a levy would not create undue financial hardship. Assuming the Committee shares our understanding that the repeal was inadvertent, we recommend a technical correction to reinstate that authority.

TECHNICAL CORRECTIONS TO OTHER ACTS

Many other technical changes are proposed with respect to the acts mentioned above. We fully support these changes. Moreover, we expect that other necessary technical amendments will be suggested as these proposals are reviewed and discussed by interested parties. We look forward to working with the members of your Committee in developing these proposals.

Finally, it should be noted that the provisions in the bill are generally effective retroactive to the effective date of the corrected legislation. As a general rule, these retroactive effective dates are appropriate. However, there may be instances in which retroactivity operates harshly and unfairly to affected taxpayers. We believe that the possibility of prospective effective dates for certain provisions should be considered in appropriate situations.

REVENUE EFFECT

This bill has no significant revenue effects.

I would be pleased to answer any questions you may have.

Mrs. KENNELLY. Our next witness will be Prof. Martin D. Ginsburg of the Georgetown University Law Center in Washington, D.C.

Good morning, Dr. Ginsburg.

STATEMENT OF MARTIN D. GINSBURG, PROFESSOR, GEORGETOWN UNIVERSITY LAW CENTER

Mr. GINSBURG. Good morning.

I will confine my oral comments this morning to the corporate tax provisions, some that are in the Technical Corrections Act and, as Mr. Rollyson has suggested, some that are not but I believe ought to be.

The written statement to which he was kind enough to refer has been submitted. It is similarly focused. It is, I regret in more ways than one, terribly long. On the assumption the committee plans to adjourn for dinner, I will limit my comments to a small part of it.

Mrs. KENNELLY. Professor, the whole statement will be put in the record.

Mr. GINSBURG. Thank you, Madam Chairwoman.

The pamphlet on the Technical Corrections Act by the Joint Committee staff well identifies a substantial majority of the misfortunes of the 1982 legislation that cry out for technical correction. I think there are, in addition, about half a dozen technical uglies that have not been addressed in the Technical Corrections Act.

I would like to address briefly one of the changes that is in the act, and then turn my attention to the six that are not.

My focus here is on section 338, It announces that when a purchasing corporation, which all tax people call P—purchases the controlling stock of a target corporation—which we call T—the purchasing corporation can step up the basis of the assets of the target company to reflect the stock purchase price and hence the fair market value of the assets, and incur the attendant recapture costs, in a very simple way. Check a box and file a form with the Internal Revenue Service.

This is a wonderful notion. In the old days you had to liquidate the target company to get that tax result and this was a great boon, I think, only to landlords.

Liquidation requires a transfer of assets. If the target company was operating in leased premises, surely the lease provided that the consent of the landlord to any transfer would be required, and probably went on to say, "which consent will be unreasonably withheld."

So all of the commercial lawyers think it marvelous that we no longer are forced to incur costs of that sort. I think it marvelous too.

A significant problem that has emerged, under section 338 relates to the calculation of the deemed selling price of the assets of old target company and the new target company's deemed purchase price for those assets. These are important matters. Deemed selling price determines how much depreciation, recapture and recapture tax will be incurred. Deemed purchase price determines what the basis of the assets will be in the hands of new company T.

The formula in the present statute, the 1982 TEFRA enacted statute, is a sort of four-valued formula. It starts with an assumption, intuitively reasonable but in fact wrong, that the selling price and the purchase price ought to be the same deemed amount. It then says, We will look to something called the grossed up basis of the target company's stock in the hands of the purchasing corporation properly adjusted for liabilities and for other relevant items, all as the regulations will prescribe." But if you try to apply this formula in any case that is not plain vanilla, the answer seems to come out wrong.

Congress has perceived this. The act adopts what seems to me, basically, a very sensible approach. It says, "We will treat the affair as if the assets had been sold at fair market value and as if the assets had been purchased for purposes of determining the asset basis in the future, at a purchase price equal to fair market value adjusted in a specific way.

Fine, as far as it goes. The difficulty is that in dropping out all of the current statutory formula, the act has gone too far. Nothing in the new proposal deals with this important class of cases, what happens when, after the date the stock was purchased, there are adjustments to the stock purchase price?

The seller is found to have breached a warranty and must pay money back. Or, the stock purchase contract calls for contingent payments based upon the income of the target company in future years, and payments are made in future years.

In the TEFRA committee report, Congress showed it was well aware of these sorts of problems. It provided for them in the 1982 statute. I think what we really must do is preserve in the statute the current authority for regulations to deal with post-acquisition date relevant items. If we do it will not only handle the cases I referred to, purchase price adjustments and so on, but as pointed out in the written statement, also will provide a mechanism through which to resolve in a more coherent way other problems that the act attempts to deal with incoherently.

On analysis, all these concerns turn out to be variations of one problem. They all require asset basis adjustments rather than dis-

parate reactions. If you adopt one rule to deal with one problem, you do a lot better. The rest of the analysis I leave to the written statement.

I would like with your indulgence, to devote the balance of my time to technical corrections that are not currently in the act, but which seem to me to deserve serious consideration by this committee. There are six of them and they group as follows: two in the bailout area mainly section 304; one in the partial liquidation area; and three in section 338—a nice mix.

In section 304, there is one really large problem and one smaller one. To remind the committee of that which it knows better than I, what section 304 says in general, or at least tries to, is that if Mr. A owns the controlling stock of both X corporation and Y corporation and sells the shares of X to Y retaining indirectly through Y pretty much the interest he had in X before the transaction, he cannot treat that as a sale. It is a dividend and the statute treats it as such.

Now, in the main, this works well enough when the seller is Mr. A or Ms. A, but it works abominably, it reaches truly lunatic results, when the seller is itself a corporation selling the stock of one controlled subsidiary to another controlled subsidiary. In the written statement I have proffered a few examples that shows some of the amazing things that happen.

Half the time the taxpayer is excessively burdened and the other half, because he or she or it had a better lawyer, it is the fisc that is excessively burdened a sort of balance of terror.

Now, this has been a lurking problem in section 304 from 1954, the day of creation, but it became a larger problem as a result of the TEFRA amendments to section 304. It really cannot be addressed successfully in a tinkering way, as the act in part attempts to do. The problem must be addressed, I think, by recognizing that the statute really has no sensible function when applied to a corporate seller.

The statute properly addresses cases in which individuals bail money out of corporate solutions, transactions that ought to be treated as dividends but on their face would not be. It is exclusively to this problem that section 304 should be limited.

The other section 304 matter is a very narrow one. Congress in 1982 made a valiant effort to redefine the term "control" in the statute to catch a number of egregious tax avoidance schemes. I think simply because of the technical drafting, it caught all but one. The written statement points out the one that was missed, the so-called Cooperative bailout. We ought to catch it, too.

In the area of partial liquidations and analogous distributions, TEFRA did a good job in the main, plugging two major tax avoidance schemes. But, as always seems to happen in the corporate tax arena, it opened up, or at least gigantically expanded one new one.

It is rather fun to think about this one using a very simple example. P corporation buys 70 percent of the stock of T, a target company, and pays, let us say, $70 million, the stock's fair value. Next, the target company, which operates various businesses, distributes in a partial liquidation all but one of its businesses to its shareholders.

Now, as a result of the TEFRA amendments, that distribution is essentially tax free to P, the recipient of 70 percent. Assuming T has full E and P, it is treated as a dividend to P and the maximum rate of P's tax is 6.9 percent on the lower of the bases or value of the distributed property. Relatively, nearly no tax.

P takes the distributed assets at a carryover basis, and that is what Congress intended. But what Congress in 1982 did not consider was this: If P receives $50 million worth of property in that distribution from the target corporation so that P's investment in target is now worth only $20 million, P still holds the target company's shares at a basis of $70 million.

The rest of the scheme explains itself. P now sells the T stock to a third party and recognizes a $50 million short-term capital loss which P sets it off against the short-term gains it had this year or, by carrying back, during the past 3 years, Congress has in the case I described literally thrown $25 million of tax recoupment at P. That is a wrong answer.

What we should do is what we did before TEFRA in these sorts of things. We did not allow stock basis to remain $70 million. In the example, $50 million of the T stock basis should be withdrawn. The partial liquidation should not be turned into a new form of tax avoidance device.

With respect to section 338, I will pass over one delightful problem, the accidental repeal of the collapsible corporation provision because it is an oversight, easy, I think, to deal with as suggested in the written statement. But there are two other concerns I believe to be greater.

One is the problem of a transitory purchasing corporation. This is a genuine trap for the unwary, one that probably, has been sprung 30 or 40 times by now on people who simply don't know they are in trouble. If an individual wants to buy the stock of a target corporation, and to make the section 338 election to step up the basis of T's assets, Congress has said he cannot go it alone. Mr. A, in this case, must organize a dummy corporation, again P corporation, and it will make the purchase and the election.

Now, Congress did that in 1982, not to hurt or encumber individual taxpayers, but rather for their benefit. By doing it this way, Congress avoided extending the consistency requirement of section 338(e) to individuals, which is a great boon to individuals.

But, there is an unintended detriment. After P purchases the target company's stock, we have a two-tier corporate structure that probably does not make any commercial sense. Mr. A may wish to get rid of the two tiers; it will save him money. And, if there is a lender in the picture that has financed the purchase, the lender may insist that the two companies be combined.

Now, there are three ways to simplify the corporate structure. One is to liquidate P. Another is to merge P downstream into the target company. And the third is to liquidate the target company upstream into P.

The first two ways are perfectly fine because they do not require any transfer of the assets of the target company, given the choice, invariably the lawyers will do it one of those two ways.

The difficulty is that under what is called the step transaction doctrine, it is not at all clear that if the lawyers do the commercial-

ly sensible thing, they will not lose for Mr. A the benefit of the section 338 election that Congress proposed in 1982. So, to be safe, the well-advised liquidate the target company upstream into P, which means that exactly what Congress said you do not have to do, transfer the assets from T to P, turns out to be what in safety you must do.

Those who don't see the problem, of course, will never do anything that commercially silly, and so they do it in a way that raises the tax risk. Right now half the world does not know there is a problem and is taking the risk, and the other half knows there is a problem and is incurring all sorts of dead weight commercial costs to avoid it.

What is needed here is simply some direction from Congress. The current complexity is not what Congress intended. This committee simply should announce, either in the statute or in the committee report, that section 338 does not require that Mr. A maintain the separate existence of P corporation after the qualified stock purchase transaction.

Congress has no reason to hesitate. In the TEFRA committee report on the Senate side in 1982, Congress pointed out it is perfectly acceptable for P to transfer the T stock to an affiliate the day after P has acquired that stock. If it is OK to transfer the T shares, certainly it ought to be OK to dispose of the company that is transferring the shares.

Finally, there is a difficulty in the area of estimated tax. Hard as it is to believe, if P acquires T by purchase and thereafter makes a 338 election, it likely turns out that T is retroactively in default of estimated tax payments and thus is required to pay nondeductible penalties. There is no effective mechanism in the Internal Revenue Code either to make timely payment or to permit waiver of the penalties.

Taxpayers, when they fully understand this, will become very grumpy. This problem, it seems to me, is quite easy to deal with. Just give the Treasury Department what it does not now have, authority to write regulations under which penalties can be waived consequent upon the payment of the interest that is appropriate to the overall transaction.

I would like to close with one more note. It is not an easy one to sing before a tax-writing committee.

We are drowning in this country in new tax legislation. We are drowning in enormously complicated, confusing and uncertain new tax legislation. It is important that a technical corrections bill be enacted swiftly because you are correcting with needed speed what was not worked out well in the preceding year or years. But it is more important that new changes, new tax laws, be given more careful thought.

In the corporate tax arena, in which we deal this morning, Congress had only 104 days in 1982 to write a truly mammoth set of changes, and during most of that brief time Congress was busy with other and more important things. The result in significant part was truly unfortunate, a very, very difficult statutory scheme.

I think all of us would feel vastly better—all those people out there, taxpayers who do not understand these things, tax practitioners who can no longer understand what is happening in the

law, and, Lord knows, a poor school teacher who certainly cannot understand these things—if Congress would, in new tax legislation, go slow.

Mrs. KENNELLY. Thank you, Professor. You are to be commended for your incredibly clear and interesting testimony. I thank you.

Do any of the members wish to ask questions of Professor Ginsburg?

Thank you very much, sir.

Mr. GINSBURG. Thank you, Madam Chairwoman.

[The prepared statement follows:]

STATEMENT OF MARTIN D. GINSBURG

Mr. Chairman and Members of the Committee; my name is Martin D. Ginsburg. I am a professor of law at Georgetown University Law Center where I teach various subjects in the field of federal taxation. For some twenty years prior to becoming an academic, and with a more modest time commitment since, I have practiced law primarily in the federal tax field.

In May and June of last year, I had the privilege of testifying before a Subcommittee of this Committee on H.R. 6295 and H.R. 6055. The former, with a number of modifications, became the TEFRA subchapter C amendments; the latter, with some changes, the Subchapter S Revision Act of 1982. The Bill that is before the Committee this morning would correct technically these and other recent tax enactments. I will focus my comments on changes in the subchapter C provisions and on the portion of the subchapter S legislation that interrelates in a direct way with these provisions of subchapter C. The discussion that follows is bifurcated. First, the changes proposed in H.R. 3805. Second, some further changes, not now proposed in the Bill, that seem to me needed or, at the least, highly desirable.

I. PROPOSED TECHNICAL CHANGES

The 1982 TEFRA amendments to subchapter C may be grouped, conveniently if imprecisely, under three headings: Anti-bailout rules (amendments to sections 304, 306, and 356 of the Code), provisions governing partial liquidations and analogous distributions (amendments to sections 302, 311, 331, and 346), and the enactment of new section 338 (with correlative repeal of old section 334(b)(2)). There were of course other 1982 changes in subchapter C, notably in section 368(a)(1)(F) defining a "mere change in form" reorganization, but none is on the Committee's plate this morning.

A. Antibailout provisions

1. § 304(b)(2)(A)—amount constituting dividend: As originally amended by TEFRA, section 304(b)(2)(A) announces that when a shareholder (Mr. A) sells stock of one corporation (T), in which he holds a controlling interest, to another corporation (X) of which he is also in control, the determination of the amount which is a dividend to Mr. A shall be made as if the property, received by him in the sale, were distributed by T to X and immediately thereafter distributed by X to Mr. A. If X has earnings and profits insufficient to cover the distribution but T's earnings and profits are ample, section 304(b)(2)(A) will "push-up" to X earnings and profits of T and thereby convert the distribution received by Mr. A to a taxable dividend. But, as written in 1982, the statute would "push-up" earnings and profits of T whether or not the earnings and profits of X, viewed independently, are sufficient to cover the entire distribution.

While the 1982 amendment appeared to close one loophole under prior law, unintentionally it opened one or more new ones. If Mr. A were A Corporation, the draining of T's earnings and profits would hardly generate disadvantage since a corporate shareholder obtains the section 243 intercorporate dividend deduction. But another, non-corporate shareholder of T would be greatly advantaged if, in the following taxable year, T distributed to her money which, for lack of earnings and profits, became a non-taxable return of basis. Additionally, if T were a controlled foreign corporation, the draining of its earnings and profits incident to the transaction between A Corporation and X Corporation could produce the unintended equivalent of a repeal of section 1248.

The Bill reacts to these potentials for abuse by limiting the drain on T's earnings and profits to the amount, if any, needed to cover any shortfall in the earnings and

profits of X. While this is an improvement over present law it is not an adequate reaction to the problem. If A Corporation is the seller of T stock and the earnings and profits of X are low or nil, the technical correction will have little impact.

There is, in addition, a separate technical problem, in measuring the earnings and profits "push-up," to which the Bill currently does not react. If the property distributed by X to Mr. A has, in the hands of X, a low basis relative to its value, the statute limits the earnings and profits shift to that lower amount. Although an application of section 311(d)(1) should, in many cases, provide a cure by generating additional earnings and profits in X, it is not clear that any cure is available, and that any earnings and profits of T shift to X, if the property received by Mr. A is a debt obligation issued by X.

In sum, notwithstanding the proposed technical correction, there appear to be cases in which earnings and profits will be drained from T when that is not the desired or sensible result, and there may be cases in which earnings and profits of T will not shift to X when that shift is the desired and sensible result.

The latter concern could, as a practical matter, be obviated if section 304(b)(2)(A) were further amended to provide that when the "property" deemed distributed is a debt obligation of the acquiring corporation, it shall be treated as having a basis equal to the face amount of the obligation. The former concern, an inappropriate drain of T's earnings and profits when the selling shareholder is itself a corporation, is part of a larger problem that merits an encompassing resolution. That problem and a suggested resolution are addressed below in Part II A 1.

2. § 304(b)(3)—coordination with section 351: Two separate technical corrections are proposed in the Bill. The first addresses this case:

Example (1). T. Corporation and X Corporation are of equal value. Each has 100 shares of common stock outstanding. Mr. A owns all of the T stock and 50 shares of X stock. On October 1, 1983, Mr. A transfers all of the T stock to X and receives in exchange 50 additional shares of X stock and cash in an amount equal to one-half the total value of T. Assume earnings and profits adequate to cover the full amount of the cash.

It is clear, and correct, that the cash distributed to Mr. A falls under section 304(a)(1). Under section 304(b)(3)(A) as enacted in 1982, it is not clear whether Mr. A's receipt of the additional 50 X shares gives rise to capital gain or to no recognized gain. Since Mr. A will own less than 80 percent of the outstanding stock of X, section 351 is not applicable to the described exchange. But, under the 1982 statute, it is arguable that sections 368(a)(1)(B) and 354(a)(1) apply to provide nonrecognition treatment. The Bill would eliminate that argument and, appropriately in relation to the balance of present law, confirm that Mr. A must recognize gain on the exchange of stock.

Section 304(b)(3)(B), in its generous treatment of stock transferred encumbered by acquisition indebtedness, inadvertently overturned *United States* v. *Davis*, 397 U.S. 301 (1970). While that decision is fairly subject to criticism and might well merit congressional reexamination in some of its aspects, it ought not be overturned by accident. The Bill reverses the 1982 error by rendering the acquisition indebtedness provision unavailable if the liability was incurred in acquiring the stock from a related person (section 318(a) attribution eliminating the option attribution provision of paragraph (4) of that subsection).

The Bill's response is straightforward and comprehensible, but in some respects extreme.

Example (2). Mr. A borrows money from a bank and uses the funds to purchase 60% of the stock of T Corporation from M, Mr. A's mother. The other shares of T are owned by unrelated persons. At the time of sale M, who had owned her T shares more than 10 years, severs all connection with T (as an officer director, and employee). Mr. A also owns all of the stock of X Corporation and M has no connection with it. Mr. A contributes to X the T shares he recently purchased, X assumes the acquisition indebtedness to the bank, and Mr. A is relieved of that liability.

Under the Bill Mr. A has engaged in a section 304(a)(1) transaction and, to the extent of available earnings and profits, will be deemed to receive dividend income even though he has received and will receive no cash from X. This is a strong statutory response to the perceived problem; had better tax advice been available at the outset, dividend treatment might have been avoided entirely. If X had borrowed the required funds from the bank and used the money to purchase the T shares directly from M, Mr. A would have incurred no tax liability and M, filing the statement required by section 302(c)(2), might have enjoyed capital gain on the sale.[1]

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[1] M would enjoy capital gain unless the arrangement were found to fall within the prohibition of section 302(c)(2)(B)(ii), as to which present law does not seem to furnish a definitive answer.

The Bill's rather inflexible approach is defensible on simplicity grounds. Were Congress minded to adopt a provision more coordinate with the approach Congress has taken to redemption transactions under section 302, it could revise the proposed technical correction to provide absolution for Mr. A if a direct purchase by the acquiring corporation of the target shares from the original owner would have been treated as a payment in exchange for the stock and not as a distribution of property to which section 301 applies.

3. §§ 304(c)(3) and 306(c)(4)—constructive ownership: The Bill ameliorates a long-standing technical problem in the section 304(c) constructive ownership rules. Under a literal reading of those rules, there are unusual but not inconceivable circumstances in which any degree of cross-ownership, no matter how small, may give rise to common control. The bill substantially eases, but does not fully solve, the problem by inserting a 5 percent floor in the pertinent corporate-shareholder attribution provisions. While this likely will suffice in most of the cases in which the issue may emerge, a 20 percent floor would perform the task with greater assurance and safety while placing the fisc in no apparent jeopardy.

The proposed amendment to section 306(c)(4) is parallel and the percentage floor figure, whether 5 percent or 20 percent or something between, should be the same in both provisions.

B. Partial liquidations and analogous distributions

1. § 311(e)(1)(C)—Qualified stock: pass-thru entities: Under the statute as enacted in 1982, a person (other than a corporation) who at all times during a 5-year period owned at least 10 percent in value of the outstanding stock of a corporation holds all shares in that corporation (whenever purchased) as "qualified stock." A pass-thru entity such as a partnership can hold qualified stock even if none of its partners, viewed separately, would satisfy the 10 percent ownership requirement. The Bill would add a new subparagraph (C) to section 311(e)(1). Under it the qualified stock test will be applied, with regard to both percentage and time of stock ownership, at the investor and not the entity level.

The change is appropriate.

2. § 318(e)(1)(B)—qualified stock: attribution rules: In determining stock held for purposes of the 10 percent ownership requirement, section 311(e)(1)(B) applies, to the benefit of the distributing corporation, a modified section 318(a) attribution rule. The modification relates solely to family attribution.

Although the Bill proposes no change in this regard, a further modification, consistent with the Bill's pass-thru entity provision, should be made. The need for it is shown by the following example.

Example (3). Mr. A and Mr. B, unrelated individuals, each owns 6 percent of the outstanding stock of X Corporation. Each has owned those shares more than 5 years. They are and for more than five years have been parties to a cross option agreement under which each has the option to purchase the other's X shares at fair value.

Under section 318(a)(4), by virtue of the option Mr. A is considered to own the shares held by Mr. B. Similarly, Mr. B is deemed to own Mr. A's shares. Under a literal application of the section 318(a)(4) option attribution rule, therefore, each is deemed to own 12 percent of the outstanding stock of X and each, accordingly, owns "qualified stock."

Elsewhere in recent tax enactments, for example in sections 338 and 453, section 318(a) attribution has been used eliminating option attribution. That change should be made in section 311(e)(1)(B).

C. Section 338

With a single exception, the numerous technical corrections to section 338 that are proposed in the Bill appear well directed. Set out below are a few clarifying suggestions with respect to the salutory changes that have been proposed. The single troublesome provision, new section 338(h)(7), is considered below following the discussion of the Bill's proposed changes to subsections (a) and (b) of section 338, to which changes the review of new paragraph (h)(7) directly relates.

1. § 338(h)(1), (3), (8)—certain stock acquisitions. Taken together, these proposed changes correctly resolve a series of related problems, inherent in the enacted statute, when, for example, the target corporation owns less than controlling stock of a subsidiary and the balance of the subsidiary's shares are acquired by the purchasing corporate group. The proposed changes are important and appropriate. An additional effect of the changes, also appropriate, merits attention.

Example (4). T Corporation owns 80 percent of the outstanding stock of S Corporation. The other 20 percent is owned by an unrelated person. P Corporation pur-

chases 99 percent of the outstanding stock of T and files a section 338 election with respect to T.

The committee report accompanying TEFRA pointed out that, under section 338(h) as enacted in 1982, the section 338 election with respect to T does not also function as a section 338 election with respect to S and, indeed, on the facts of the example no section 338 election with respect to S was available. Under the Bill, the section 338 election for T will result in the application of section 338 to S as well. Because the 1982 committee report now may mislead, it is urged that the committee report accompanying the Technical Corrections Act of 1983 highlight this change in result.

2. § 338(h)(11)—tandem sections 337/338 transactions: New paragraph (11) is, as a matter of commercial practice, an extremely valuable and sensible addition to the statute. The class of cases to which it is addressed may be illustrated as follows.

Example (5). Mr. A owns all of the stock of T Corporation which, for many years, has been engaged in two distinguishable business activities, respectively the X business and the Y business. T is not a collapsible corporation. On July 1, 1983. T adopts a plan of complete liquidation and promptly thereafter sells the X business to Q Corporation in exchange for cash of 1,000 and Q installment obligations (bearing adequate interest) in the face amount of 9,000. In September of 1983, T distributes the cash and Q notes to Mr. A as a first liquidating distribution. T then commences negotiations to sell the Y division to P Corporation. In the course of these negotiations, P announces that, because certain of the assets of the Y division cannot be transferred unless consents of landlords and others are obtained, P is unwilling to purchase the Y business directly but is willing to purchase from Mr. A all of the stock of T which now holds only the Y business. P agrees that upon completion of that purchase it will make a section 338 election for T. In January, 1984, Mr. A sells all of the stock of T to P for cash of 3,000 and installment obligations of P (bearing adequate interest) in the face amount of 3,000. P then makes the section 338 election for T. Because T is a continuing corporation for purposes of state corporate law (although it is "new" T for purposes of the income tax provisions of the Internal Revenue Code), P causes T to cancel the plan of liquidation it adopted on July 1, 1983.

Under the 1982 statute, the tax consequences to both T Corporation and Mr. A are unclear. Under the Bill's proposed section 338(h)(11), and in particular that provision's parenthetical reference to "provisions which relate to section 337," the tax consequences to both T Corporation and Mr. A should, appropriately, be as follows:

Section 337 applies to the 1983 sale by T of the X division to Q.

The 1983 distribution by T to Mr. A of cash and Q notes is treated as a liquidating distribution under section 331, and under section 453(h) Mr. A does not recognize gain in 1983 on his receipt of the Q notes and, instead, will report payment of the Q notes on the installment method.

Mr. A's sale of the T stock to P, in exchange for cash and P notes, is an installment sale reportable on the installment method under section 453(a).

For purposes of section 453(h)(2), the cash and P notes received by Mr. A in 1984 will be treated as if received by Mr. A by reason of the liquidation of T in a distribution to which paragraph (1) of section 453(h) applies. To protect the revenue, this treatment is necessary in order to reach a correct allocation of the basis at which Mr. A held his T shares.

If, contrary to the example, T were a collapsible corporation as that term is defined in section 341(b)(1), section 341(e) should apply (1) treating T as having sold all of its then assets (the Y business) on the section 338 acquisition date, for purposes of section 341(e)(4)(B), and (2) treating Mr. A's receipt of cash and notes of P, incident to the sale of the T stock to P, as a distribution governed by section 341(e)(2) and not as a sale of stock governed by section 341(e)(1). Rule (2) provides necessary protection to the revenue, assuring that the after-tax results to Mr. A in the overlapping sections 337/338 transaction will not be extraordinarily better (or worse) than they would have been had T sold the Y business to P and distributed the proceeds to Mr. A in completion of T's liquidation.

While these appear to be the intended, and correct, tax results, section 338(h)(11) is not wholly self-explanatory. It would be extremely helpful to taxpayers and the Revenue Service, therefore, if the committee report accompanying the Technical Corrections Act were to provide needed guidance by making the foregoing conclusions explicit.

3. § 338(h)(1)—coordination with section 333: When P purchases the controlling stock, but less than all of the outstanding stock, of T and T is liquidated within one year following the acquisition date, the 1982 statute expunges T's section 338(c)(1) "surrogate tax." The unstated assumption is that the holder of the balance of T's

shares will, under section 331, recognize gain on the liquidation. But, if a section 333 election is made for the benefit of the monority shareholder and assets other than cash and securities are distributed to her, because the intervening section 338 election has expunged T's historic earnings and profits she will recognize no gain.

Rightly, the Bill conforms the law to the assumption by requiring that, to expunge surrogate tax, T's liquidation must be one to which section 333 does not apply.

A separate, in some respects similar, tax avoidance opportunity fostered by present section 338(c)(1) is reviewed below in part II C 2.

4. § 269(b)—when section 338 is not elected: The transaction to which proposed section 269(b) is designed to attend runs along the following lines.

Example (6). Mr. A owns all of the stock of L Corporation which has a sizable net operating loss and an active business. Unrelated P Corporation is much larger and highly profitable. The businesses operated by L and P are reasonably coordinate. On September 1, 1983 P purchases for cash from Mr. A all of the stock of L. No section 338 election is made. Immediately thereafter, L is liquidated into P and P thereafter uses the former L assets in the conduct of the combined P-L business. Under sections 332, 334(b)(1), and 336, neither P nor L recognizes gain on the liquidation and P inherits the former T assets with a carryover basis. Section 382, it appears, does not apply to the described transaction. Under section 381 (c)(1), unless section 269 intervenes P will succeed to L's net operating loss carryover and may use it to offset future income of P.

In example (6), it is assumed, P's purchase of the stock of L was principally business and not tax motivated. If L were not liquidated and continued to operate as a separate subsidiary of P, L's net operating loss could be used only to offset future income, if any, generated by the business of L (in P's consolidated return the L loss is subject to the SRLY limitations). Thus, section 269(a)(1) would not apply to the stock purchase.

Prior to TEFRA, the liquidation of L under a plan adopted within two years following the stock purchase would fall under "old" section 334(b)(2). L's loss would not survive the liquidation and, obviously, there would be nothing to which section 269 then need apply.

Both before and after TEFRA, if following its purchase of the L stock P merges into L or contributes to L valuable property or profitable business assets, intending that the income thereby generated in L will be offset by L's loss, that "downstream" transfer would be subject to examination under section 269(a)(2). If found principally motivated by tax avoidance, the transfer would not achieve the intended loss utilization.

Example (6) presents a new, TEFRA-created variation. Because "old" section 334(b)(2) has been repealed, the prompt liquidation of L into P no longer expunges L's loss. While present section 269(a)(2) speaks to a "downstream" transfer of assets from P to L, present section 269 does not address the "upstream" carryover basis transfer of assets from L to P. Thus, the transaction can succeed in transferring L's loss to P, an arrangement which, as a practical matter, effectively repeals the SRLY limitations.

The Bill reacts to this concern by proposing new section 269(b). Under it, the "upstream" transfer, if made within two years following P's purchase of the L stock, will be tested for tax avoidance in the same way a "downstream" transfer from P to L is tested under section 269(a)(2). (The two year limitation in proposed section 269(b) appears to be a product of history, in effect a reference to "old" section 334(b)(2), and it is not entirely clear why proposed section 269(b) should be limited in this way.) Thus, sensibly, if P and L are combined, without regard to the direction of transfer an essentially identical set of tax rules will apply.

Unfortunately, the legislative proposal expands an area of significant uncertainty that requires clarification.

Example (7). P is a large, publicly held corporation which, through divisions and subsidiaries, operates profitable businesses. P files a consolidated return with its subsidiaries and has a substantial net operating loss carryover. Ms. B owns all of the stock of G Corporation, the business or assets of which generate substantial income and are coordinate with a business of the p group. G does not have a loss carryover. On September 1, 1983, one of P's subsidiaries (S) purchases for cash from Ms. B all of the stock of G. G thereby becomes a member of the P consolidated group. No section 338 election is made for G. Alternatively, either (1) G continues as a separate subsidiary in the P group, or (2) G is liquidated into S which uses the former G assets in its business, or (3) S, after it purchases the stock of G, merges "downstream" into G which continues to hold the assets and operate the business of the constituent corporations.

Prior to TEFRA, section 269 did not apply to a transaction in which the stock of G was purchased and G immediately liquidated. See Rev. Rul. 63–40, 1963–1 C.B. 46, and TIR No. 773 (October 13, 1965). In theory, section 269(a)(1) could apply to the purchase of G's stock if G did not promptly liquidate, but on the facts of the example, either variation (1) or variation (3), that application would appear extremely unlikely.

The pre-TEFRA rule of Rev. Rul. 63–40 and TIR No. 773, that prompt liquidation of G assured the non-application of section 269, was keyed to a Kimbell-Diamond rationale. At least in its subchapter C aspect, Kimbell-Diamond did not survive the TEFRA enactment of section 338. It is, therefore, unclear whether Rev. Rul. 63–40 and TIR 773 retain vitality when G is promptly liquidated and a section 338 election is, or is not, made with respect to G. Further, and directly relevant to the Technical Correction Bill, it is unclear whether new section 269(b), designed to deal with the example (6) case of a purchase and prompt liquidation of a loss corporation, also applies to the example (7) case of the purchase and prompt liquidation of a profitable corporation when the purchaser, and not the target, is a loss corporation.

In example (7), P can avoid any problem under new section 269(b) simply by not liquidating G and continuing it as a separate subsidiary within P's consolidated group. But there appears to be no reason in tax policy to mandate that choice since, in example (7) and unlike example (6), no SRLY limitation is applicable in any event.

Committee report clarification is greatly needed. Taking account of the demise of Kimbell-Diamond it is suggested that the committee report ought to reflect clearly the following understanding, applicable when the purchasing corporation is a loss corporation (or the purchasing group is a consolidated loss group) and the target corporation is not a loss corporation and does not hold assets with a built-in loss:

If P (the loss corporation) purchases the controlling stock of G and makes a section 338 election, the transaction is the post-TEFRA equivalent of the prior law transactions described in Rev. Rul. 63–40 and TIR No. 773, and those pronouncements will apply in determining the applicability vel non of section 269.

If P purchases the controlling stock of G and no section 338 election is made, the liquidation of G pursuant to a plan of liquidation adopted not more than two years after the acquisition date is not one to which new section 269(b) will apply, unless that liquidation permits a greater utilization of P's loss than would have been available had G continued as an includable corporation in the P affiliated group and a consolidated return were filed (whether or not a consolidated return in fact was filed). However, because Rev. Rul. 63–40 and TIR 773 now respond to the making of a section 338 election and not to the liquidation of the target corporation, when no section 338 election is made for G the purchase of the G stock by P will be tested under section 269(a)(1) without regard to whether, after the stock purchase, G continues as a separate corporation, G is liquidated into P, or P is merged into G. While section 269(a)(1) will not apply to P's purchase of the stock of unrelated G for cash or fixed payment obligations, section 269(a)(1) may be found applicable if (1) the stock purchase is for contingent payments and, in practical effect, the arrangement results in a transfer of beneficial interest in the P loss to the former G shareholders, or (2) the former G shareholders hold more than a nominal stock interest in P.

5. § 338(a) and (b)—deemed asset sale and purchase prices: Under section 338(b) as enacted in 1982, "old" T is treated as having sold its assets, and "new" T as having purchased those assets, for an amount equal to the "grossed-up basis" at which P (the purchasing corporation) holds its T stock, "properly adjusted" under forthcoming regulations for T liabilities and "other relevant items." When P owns all of T's stock, P's basis in the shares is "grossed-up basis;" when P owns less than all, "grossed-up basis" is P's basis in the T shares it owns, divided by the percentage (in value) of T's shares that P owns. The T liabilities to be taken into account presumably include recapture tax incurred by T incident to the section 338 deemed sale of its assets, but presumably do not include section 338(c)(1) "surrogate tax" incurred when P does not own all of T's outstanding stock within one year following the acquisition date. "Other relevant items" include subsequent purchase price adjustments, for example when P has agreed to and later does make contingent additional payments for the T stock it has purchased; it is not clear what other items may be "relevant."

Because it acts to reduce the deemed asset selling price, as well as the deemed asset purchase price, and because the reduction formula it applies does not work correctly in a significant class of cases, present law in many circumstances will not reach a sensible result. Two examples will make the point.

Example (8). The outstanding stock of T consists of 100 shares of voting common stock. T is worth 1,000 and each share of T is worth 10. Mr. A owns 80 T shares, Ms

K owns 10 T shares, and P owns (and has owned for many years) 10 T shares at a basis of zero. On July 1, 1983 P purchases for 800 the 80 T shares from Mr. A and makes a section 338 election for T. While, sensibly, the "grossed-up basis" of the 90 T shares held by P should be 900, under present law "grossed-up basis" is approximately 889 (800 divided by 90%).

Example (9). The only asset of T is a milling machine worth 2,200 which T purchased some years ago for not less than that amount. The adjusted basis of the machine in T's hands currently is 1,000. T has no liabilities. T has outstanding two classes of stock: 50 shares of voting common stock owned by Mr. A, and 50 shares of non-voting convertible preferred stock owned (for many years) by P. Because the preferred stock is convertible into an equal number of shares of T common stock, the preferred stock is worth 50 percent of the total value of T. P's basis in the preferred stock is 200. P purchases from Mr. A the 50 shares of T common stock paying a purchase price of 800 (although T's asset is worth 2,200, it is burdened by potential recapture tax of up to 600 and thus Mr. A's shares are worth only 50 percent of 1,600 or a net of 800). P files a section 338 election for T. Because P owns all of T's outstanding stock, "grossed-up basis" equals P's actual basis in all of the T stock, a total of 1,000. Since T has no pre-section 338 election liabilities and there do not appear to be "other relevant items," the price at which "old" T is deemed to sell its milling machine to "new" T is 1,000. On that deemed sale "old" T will recognize no gain (asset basis is 1,000). In the hands of "new" T, the basis of the milling machine will be 1,000. Because "new" T is deemed to have purchased the asset, on its resale of the milling machine to a third party 13 months later for, say, 2,200, "new" T will recognize long-term capital gain (except to the extent "new" T has taken depreciation on the machine in the 13 month interim). In the result, for "old" T the recapture rules of section 1245 have been repealed.

Reactive to these serious concerns, the Bill amends section 338 to provide that, effective in the calculation of both recapture income and section 338(c)(1) surrogate tax, "old" T is treated as having sold its assets at fair market value. "New" T is treated as having purchased the assets at an "adjusted fair market value" equal to fair market value less the amount of net unrealized appreciation, if any, in the T stock held by P on the acquisition date. The presumed, and appropriate, intention of the latter rule is to confirm that P's acquisition date basis in its T stock, and "new" T's net basis (basis less liabilities) in its assets, will be the same.

The Bill's approach—fair market value sale price and "haircut" value purchase price—is a sensible and, in most respects, greatly simplifying concept. In particular, it restores the "recapture" balance that existed under prior law and inadvertently was upset in TEFRA: In every taxable corporate acquisition, whether of the assets of T in a section 337 transaction or of the T stock in an old law section 334(b)(2) or a new law section 338 transaction, the measure of recapture gain under sections 1245, 1250, and the like should be the same. As example (9) confirms, this is not so under section 338 as enacted. But, as ever in subchapter C, a few matters merit special attention.

a. Post acquisition date adjustments in T stock purchase price; The fair market value formulation presents one obvious difficulty.

Example (11). Mr. A owns all of the stock of T. T recently was awarded a patent which may prove to be of little value or of great value. Setting aside the patent, the balance of T is worth 1,000. P purchases the stock of T paying 1,000. P purchases the stock of T paying 1,000 in cash and agreeing to make a further payment (with adequate interest) at the end of five years equal to a stated percentage of the gross income generated by the patent during years three through five. P files a section 338 election for T.

If, instead, T had adopted a plan of complete liquidation comporting with section 337 and sold its assets to P for the same consideration, P's basis in the acquired assets initially would be 1,000 plus the T liabilities assumed by P. On the facts, the basis initially assigned the patent by P likely would be zero, or close to zero. At the end of five years, the contingent purchase price payment (if any) made by P to Mr. A (as successor in liquidation to T) would, at that time, give rise to an addition to the basis at which P then holds the patent.

On its face, the proposed amendments to section 338, in looking to "fair market value," do not readily accommodate an identical result in example (11). If the acquisition date fair market value of the patent were estimated at 300 and the balance of T's assets confirmed to be worth 1,000 plus an amount equal to T's liabilities, the deemed selling price of the patent would seem to be 300 while the demand purchase price of the patent would (assuming an appropriate allocation of the "haircut") be zero. Nothing in the Bill would increase the gain realized by "old" T, or the basis at

which "new" T holds the patent, at the end of year 5 if P properly were to pay Mr. A an additional 500 at that time.

These tax results should not be different in a "deemed" asset transaction under section 338 and in a "real" asset transaction under Section 337. The familiar answer in the correct one: "Old" T should not realize gain, and "new" T should not be awarded asset basis, unless and until P's contingent liability to pay additional stock purchase price matures into a firm obligation fixed in amount.

The technical correction to subsections (a) and (b) of section 338 should be revised to preserve in the statute the accommodation to post acquisition date events that inheres in the present statute's concept of proper adjustments for "other relevant items." As the Committee report can and implementing regulations presumably will make clear, post acquisition date events relevant to sale and purchase prices include contingent payments and adjustments of stock purchase price, for example to reflect a breach of the seller's warranties or covenants. Under the Bill, automatically, the "adjusted fair market value" of T's assets and thus the acquisition date deemed purchase price of those assets will not include any amount attributable to contingent future payments. It should be made clear in the Bill that the fair market value of T's assets on the acquisition date, and thus the deemed selling price of those assets on the acquisition date, shall be determined and allocated in a manner that will prevent "double counting" recapture income or "surrogate tax" gain that later will be recognized when and if P is obliged to make a contingent purchase price payment for the T stock. Once again, in all of this the objective is to reach the same gain recognition and asset basis results that would have obtained had P bought the assets rather than the stock of T.

b. Allocation of asset basis: Under the Bill's new section 338(b)(4), the "adjusted fair market value"—the aggregate fair market value of T's assets as of the close of the acquisition date less any net unrealized appreciation (fair market value less basis) in the T stock held by P on the acquisition date—shall be allocated as basis among the T assets under regulations to be prescribed. Setting aside purchase price adjustments, described above, the statute's formula appears satisfactory but, to eliminate the risk and the perception of unfairness, it is highly desirable that the Committee report furnish clear direction.

Example (12). T has 100 shares outstanding, 80 owned by Mr. A and 20 by Ms. K. T has no liabilities and its only assets consist of land and building. The adjusted basis of the land is 1000. The adjusted basis of the building, which has been depreciated on an accelerated method and is section 1250 property, also is 1000. The building's maximum recapturable depreciation is 4000. On July 1, 1983, P purchases all of the stock of T paying Mr. A and Ms. K a total of 5000. A section 338 election is made. P obtains valid appraisals confirming that the land is worth 3500 and the building is worth 2000. (For convenience of computation, in this and in the examples that follow the § 11 tax rate is assumed to be 50 percent and the corporate capital gain tax rate 25 percent).

The appraisals have confirmed that the T stock is worth the 5000 that P paid for the T stock. Although the aggregate appraised value of the T assets is 5500, upon the section 338 election the building's 1000 of appreciation attracts recapture tax (we will for convenience assume) of 500. Since the value of the T stock held by P (5000) does not exceed P's basis in the T stock (also 5000), the "adjusted fair market value" of T's assets is equal to the aggregate fair value market (5500) of those assets. The total basis of the assets of "new" T is thus 5500, allocated 3500 to the land and 2000 to the building.

Example (13). The facts are the same as in example (12) with this difference. P was able to purchase all of the T stock for 5000 because Mr. A and Ms. K were in financial distress. Valid appraisals confirm that P has paid a bargain price for the T stock because, while the building is worth only 2000, the land is worth 4500.

As before, T's recapture income on the section 338 deemed sale of assets is limited to 1000 and the recapture tax is 500. Since the deemed sale of T's land attracts no recognition of gain to T, it is irrelevant to T that the deemed sale price of the land is 4500 rather than the 3500 of example (12).

The bargain purchase does, however, affect the analysis for "new" T. The fair market value of the T stock owned by P is 6000 (value of T assets 6500 less T recapture tax liability of 500).[2] Because P's basis in the T stock is only 5000, net unrea-

[2] This conclusion would be reinforced if proposed section 338(b)(3)(A) were revised to refer to the fair market value of the T stock held by P "as of the close of the acquisition date." As drafted, the statute refers to stock held "on" the acquisition date.

lized appreciation is 1000 and hence the "adjusted fair market value" of T's assets is, as it was in example (12), 5500 (aggregate fair market value 6500 less 1000 unrealized appreciation in the T stock held by P.

Newly placed in issue in example (13) is the proper method of allocating that 5500 of aggregate basis among the assets of T, namely the land worth 4500 and the building worth 2000.

If allocation were made in accordance with relative fair market values, T would hold the land at a basis of approximately 3800 and the building at a basis of approximately 1709. That result will, however, be widely perceived as unfair and inappropriate. The problem is a simple one: recapture tax was extracted based on a deemed sale price for the building of 2000, but under a "relative fair market values" allocations formula the building has been awarded a new basis for future depreciation of only 1700.

The concern is valid and the appropriate response, fortunately, is both apparent and convenient. In explaining new section 338(b)(4), the Committee report should direct a stacking order for the proper allocation of asset basis. Aggregate asset basis, determined under the "adjusted fair market value" formula, should first be allocated to assets the deemed sale of which generated recognized gain in "old" T, up to the amount taken into account in that recognition calculation. The balance of the aggregate basis should be allocated so that, subject to the stacking order mandate, basis is coordinate with relative fair market values.

Applied to example (13), the stacking order formula yields an appropriate result. Of the 5500 aggregate basis, 2000 is first allocated to the building. The balance of 3500 is allocated entirely to the land. Had there been two parcels of land each worth 2250 (rather than the one parcel worth 4500), each parcel would be awarded a basis of 1750.

Example (14). The facts are the same as in example (13), except that only Mr. A and not Ms. K is in financial difficulty. On July 1, 1983, Mr. A sells his 80 T shares to P for 4000 and P files a section 338 election. Three months later, P purchases the balance of 20 T shares from Ms. K paying her 1200.

In example (14) P made a qualified stock purchase of T (Mr. A's 80 percent) paying a bargain price, and within one year thereafter purchased the balance of the T stock paying for that final 20 percent full fair market value. It is appropriate to analyze first the tax situation as it stood on and immediately following the July 1 acquisition date, and then consider the impact of P's later purchase of the balance of the T stock.

At the close of July 1, "old" T is treated as having sold its land and building for fair market value, 6500. As in example (13), recapture tax is 500. If P does not purchase (and T does not redeem) Ms. K's 20 T shares within one year, that failure will confirm section 338(c)(1) "surrogate tax" liability, imposed on "old" T, of 175 (25percent assumed capital gain tax rate times 20 percent times the difference between 4500 land value and 1000 land basis in "old" T).

At the close of July 1, P's basis in its 80 percent of the T stock is 4000. The value of the T stock then owned by P is 4800 computed as follows. From the total value of T's assets, 6500, the total recapture tax liability of 500 must be subtracted. The potential section 338(c)(1) "surrogate tax" liability of 175 should not be subtracted since, among other reasons, the "surrogate tax" will never become a liability of T if the T shares held by Ms. K are purchased (or redeemed) within the following year. The potential section 338(c)(1) tax, therefore, is not a matured factor in the acquisition date basis equation. Thus, the net unrealized appreciation in the T shares held by P at the close of the acquisition date is 800 (4800 value less 4000 basis). Therefore, the "adjusted fair market value" of T's assets is 5700 (6500 total value less 800 net unrealized appreciation in T shares held by P).

Under the stacking order formula, the total basis of 5700 is allocated 2000 to the building and 3700 to the land.

If within one year P does not purchase (and T does not redeem) Ms. K's 20 T shares, "old" T will owe surrogate tax libility of 175 but no adjustment should be made in the bases at which "new" T holds the land and building.

In example (14), however, P does purchase the final 20 shares from Ms. K within one year and pays to her a full fair market value price of 1200. Section 338(c)(1) "surrogate tax" is thereby expunged nunc pro tunc. No adjustment should be made, or is needed, in the bases at which "new" T holds the land and building. Indeed, the purchase at 1200 has confirmed the correctness of the asset basis calculation. Had P purchased Ms. K's 20 T shares on the July 1 acquisition date paying her 1200, while paying Mr. A only 4000 on that date, the "adjusted fair market value" formula would have yielded an aggregate asset basis of 5700 and the stacking order alloca-

tion formula would have attributed 2000 of that basis to the building and 3700 to the land. These are exactly the results the formulae reach in example (14).

Example (15). The facts are the same as in example (14) except that P purchases Ms. K's shares three months after the July 1 acquisition date, at a price of 1000.

This is the troubling case. If P had purchased Ms. K's T shares for 1000 on the July 1 acquisition date, and not three months later, the basis of the building to "new" T would be 3500, as in example (13). Solely because the stock purchase was delayed, the basis of the building to "new" T is 3700, as in example (14).

Example (15) thus focuses the following question: Should the 200 differential be treated as an "adjustment," equivalent to a post acquisition date contingent payment or purchase price adjustment of the sort reviewed in item "a" above, for which the regulations may prescribe an asset basis adjustment in "new" T? Here, a reduction from 3700 to 3500 in the basis at which "new" T holds the building?

In example (15), the apparent answer is yes. But an affirmative answer is not inevitably correct. It may be, for example, that between the July 1 acquisition date and the later date on which P purchases Ms. K's shares, there has been a substantial decline in the value of the land or the building or both. In that event, an adjustment in asset basis would be inappropriate.

In recognition of the spectrum of permutations of fact, and the potential of manipulative tax planning through delaying part of the total stock acquisition, it is urged that the Committee report lay the grounding for sensible regulations, but not mandate the outcome. Thus, the Committee report should highlight the issue and announce the Committee's anticipation that the regulations, in setting forth rules of asset basis adjustment for post acquisition date contigent payments and stock purchase price adjustments, may treat P's purchase of additional T shares within one year following the acquisition date, at a purchase price per share that is different from the purchase price paid by P in the qualified stock acquisition, as the equivalent of a stock purchase price adjustment in appropriate circumstances.

6. § 338(h)(7)—section 338(c)(1) "surrogate tax" adjustment: Proposed section 338(h)(7) is the bill's single technical correction that appears ill-conceived. The concern to which the provision is addressed is not, however, insignificant, and can be illustrated simply.

Example (16). On July 1, 1983, P purchases 90 of the 100 outstanding shares of T and files a section 338 election. Ms. K continues to retain the other 10 T shares. Under section 338(c)(1), "surrogate tax" will be imposed on T measured by the smallest percentage (in value) of T stock that P does not own during the one year period beginning on the July 1 acquisition date. In order to reduce "surrogate tax," prior to July 1, 1984, P transfers a substantial quantity of assets to T in exchange for 900 newly issued T shares. P thereby increases its percentage ownership in T from 90 percent to 99 percent for the purpose of limiting "surrogate tax" exposure to 1 percent of "old" T's non-recapture gains.

Proposed section 338(h)(7) reacts to this tax avoidance planning by announcing that P's post-acquisition date increase in T stock ownership must be attributable to purchase or to a redemption by T to which redemption section 302(a) applies. Thus, the stock ownership increase in example (16), attributable to an exchange described in section 351(a), will not reduce section 338(c)(1) "surrogate tax."

The result achieved in the example case is clearly correct. Unfortunately, the proposed statute reaches an incorrect result in the three other cases to which it will apply.

Example (17). T corporation is worth 1000 and has 100 shares, outstanding, 90 owned by Mr. A and 10 by unrelated Mr. B. Mr. B also owns all of the outstanding stock of P corporation. On July 1, 1983, P purchases for 900 Mr. A's 90 T shares and a section 338 election is filed. On July 2, 1983, in the alternative, Mr. B either (x) contributes his 10 T shares to P, or (y) sells his 10 T shares to P for 100, or (z) causes T to redeem his 10 T shares for 100. Assume Mr. B's basis in the T shares was 10.

Under proposed section 338(h)(7), in all three permutations of example (17) "old" T will remain liable to pay section 338(c)(1) "surrogate tax" on 10 percent of its nonrecapture gains. In case (y), the sale to P, and in case (z), the redemption by T, the aggregate tax penalty is extraordinarily high since, under sections 304(a)(1) and 302(d), in both cases Mr. B will be required to treat the 100 he receives as a taxable dividend.

Contrast the tax consequences had Mr. B been able to obtain and afford better tax advice.

Example (18). The facts are the same as in example (17) except that the (x) contribution, (y) sale, or (z) redemption of Mr. B's 10 T shares is made prior to the July 1, 1983, acquisition date and before P enters into a contract with Mr. A to purchase his 90 T shares.

In both case (y) and case (z) of example (18), on his receipt of 100 Mr. B will recognize capital gain. In those cases and in case (x) of example (18), no section 338(c)(1) "surrogate tax" will be imposed on "old" T because, at the close of the July 1, 1983, acquisition date, P will own all of the outstanding stock of T.

A penalty will, however, be imposed in case (x) of example (18) since Mr. B, by contributing his 10 T shares to P, has avoided current gain recognition. Under the bill's proposed revision to section 338(b), the basis at which "new" T will hold its assets will be reduced below fair market value by 90, the difference between the 100 value of the contributed T shares and the basis of 10 at which P holds those shares.

The "surrogate tax" results ought to be the same in example (17), the inadequate lawyer example, as they are in example (18) in which Mr. B was better represented. To put the matter somewhat differently, in all of these cases as in the cases explored above in Part I C 5 of this submission, properly the statute should focus on the basis at which "new" T will hold its assets rather than on preservation of "surrogate tax."

The recommendation set out above in Part I C 5, urging that the Bill's new version of section 338(b) be further revised to authorize regulations directing asset basis adjustments for such post-acquisition date events as contingent purchase price payments and purchase price adjustments, also encompasses an appropriate solution to the permutations of example (17). The Committee report accompanying the Technical Corrections Act should simply catalog among the section 338(b) adjustment "events" the following: Any acquisition by P (or an affiliated corporation of P) of outstanding T shares within one year following the acquisition date, if in the hands of the acquiring corporation those T shares preserve a carryover basis; and any redemption of T shares within one year following the acquisition date from a corporate shareholder (other than P or an affiliated corporation of P), if the redemption is treaded as a distribution under section 302(d) (asset basis reduction should be measured by the difference between the redemption price and the basis of the redeemed T shares in the hands of the corporate shareholder). The first of these asset basis adjustment rules will attend to the example (17) case (x) and, by virtue of section 304(a)(1), case (y). The second rule will attend to the single redemption circumstance in which, absent the asset basis reduction, a potential of overall tax avoidance is present.

7. § 1362(e)(6)(C)—coordination with section 338: The Bill's proposed section 1362(e)(6)(C), with commendable economy and precision, eliminates an unintended trap for inadequately advised S corporation shareholders. Under the combined 1982 exactments of section 338 in TEFRA and section 1362(e)(2) in the subchapter S Revision Act, recapture gains triggered by a section 338 election ordinarily were taxed, not to the target corporation as other provisions of subchapter S gave reason to anticipate, but almost entirely to the target corporation's former shareholders. The Bill conforms the law to the anticipation. It is a salutory changes.

II. ADDITIONAL TECHNIQUE CHANGES

A. Antibailout provisions

1. § 304(a)(1)—corporate seller: In part I A 1 of this submission, it is pointed out that there are cases under section 304 in which earnings and profits will be drained from T when that is not the desired or sensible result, that these cases arise when the selling shareholder is itself a corporation, and the problem is not susceptible of a "tinkering" solution.

Example. (19). Mr. A owns all of the stock of P Corporation. P owns all of the stock of X Corporation and P owns all of the stock of Y Corporation. P, X, and Y file a consolidated return. X owns 50 percent of the stock of S Corporation, and Mr. A owns the other 50 percent of S. S is worth 400 and has F&P of 200. Y has no E&P. All corporations report on the calendar year. On December 31, 1983, X sells its 50 percent of S to Y for 200. On January 2, 1984, S redeems the S shares owned by Mr. A paying him 200.

Under present section 304, and under section 304(b)(2)(A) as it would be amended by the bill, the apparent tax results of this scheme are ridiculous. On December 31, 1983, S is denuded of its E&P, Y is not deemed to receive from S a dividened that can be taxed at even a low rate, and X is deemed to receive a dividend of 200 from Y upon which X will not be taxed because P, X and Y are filing a consolidated return. The January 2, 1984, redemption of S shares from Mr. A, although treated as a distribution to him under section 302(d), gives rise to a non-taxable return of basis and possible capital gain to him because S no longer has E&P.

One taxpayer's avoidance scheme is another's inappropriate misfortune. The following example is derived from Rev. Rul. 70–496, 1970–2 CB 75.

Example (20). Corporation X owns 70 percent of the stock of Corporation Y and 100 percent of the stock of Corporation Z. Y owns all the stock of Corporation S. Z and S each has E&P of 100. P's basis in the Y stock is 400, P's basis in the Z stock is 400, and Y's basis in the S stock is 300. On December 31, 1983, Y sells all of the S stock to Z for 500, the fair market value.

Under section 304, according to the Internal Revenue Service, the amazing results of this transaction are these. Y is deemed to receive a dividend of 200 (eligible for the section 243 deduction) from Z, although Y does not own before or after the transaction a single share of Z stock. The 300 balance of the payment received from Z is taxed to Y as capital gain, without any offset of the 300 basis at which Y held the S shares it sold to Z. Instead, because Y owns no shares of Z (which was irrelevant in the determination that Z could pay a dividend to non-shareholder Y), the 300 basis at which Y held the S stock "disappears and cannot be used to increase the basis of any asset of Y." The transaction has no effect on X's basis in the stock of either Y or Z. After the transaction Z holds the S stock at a basis of 300, and neither S nor Z has any E&P at all.

None of this makes any sense.

To put the matter simply, section 304(a)(1) should have no application when the seller is itself a domestic corporation. Were this the rule, Mr. A in Example (19) would not escape his deserved dividend treatment on the 1984 redemption, and Y Corporation in Example (20), having sold its S stock for a profit of 200, would recognize gain of 200.

Unless section 304(a)(1) is amended to exclude the corporate seller, the statute cannot be made to operate in a rational way. If that change is made, and provided a correlative change is made in section 267 to bar inappropriate recognition of loss,[3] section 304 will be left to perform its proper, anti-bailout function.

2. § 304 and § 306—corporative bailout: TEFRA expanded the definition of "control," in section 304(c), and with it the reach of section 304(a)(1), to terminate at least two tax avoidance arrangements that flourished under prior law. A third plan, less prevalent but not insignificant, was left untouched.

Example (21). X, Y, and Z Corporations are each worth 1000. Each corporation has a single stockholder, respectively Messrs. A, B and C, and the shareholders are not related. The three individuals cause P corporation to be organized. The shareholders transfer all of the stock of X, Y, and Z Corporations to P and each individual receives, in exchange, 25 P common shares worth 10 per share, 25 P preferred shares worth 10 per share, and a long-term P debenture with a face amount (and value) of 500. P thereafter operates as a holding company filing a consolidated return with X, Y, and Z Corporations.

Prior to the exchange, each individual was in control of his corporation. After the exchange, although the three individuals are together in control of P, no one of them occupies that position. Despite TEFRA's expanding amendments to sections 304 and 306, the former does not apply to the shareholders' receipt of P debentures and the latter does not taint the P preferred shares they received. Under section 351(a), A, B, and C recognize no gain on the exchanges and, when the debentures are paid and the preferred shares sold, they will recognize only capital gain.

These are not sensible tax results as a simple comparison will confirm.

Example (22). The facts are the same as in example (21) except that, when P is organized, three wholly owned P subsidiaries also are organized. X, Y, and Z each merges into a separate P subsidiary. In the merger, in exchange for the shares of their respective corporations, A, B, and C each receives the same mix of P common shares, P preferred shares, and a P debenture called for in example (21).

Here the tax consequences to the shareholders are markedly different. At the least, under section 356(a) (and setting aside section 453) each will recognize gain on his receipt of the P debenture. On the present state of unsettled case law, it appears probable, although not certain, that gain will be taxed as dividend income and the P preferred shares will constitute section 306 stock.

Section 304 and 306 ought to be expanded to require equivalent results.

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[3] Section 267(a)(1) denies a loss when property is sold, for an amount less than basis, between persons having a specified relationship. The latter term is defined in section 267(b), and it is to that provision an addition is required. New paragraph (13) might read: "Two corporations under common control (as defined is section 304(c)), if the property sold or exchanged is stock of another corporation of which either or both corporations are in control (as defined in section 304(c)).

B. Partial liquidations and analogous distributions

In the area of partial liquidations and analogous distributions, the TEFRA amendments in closing one loophole substantially expanded another. Two illustrations, the first a classic partial liquidation, the second analogous but involving a distribution of shares rather than operating assets.

Example (23). On December 15, 1982, P purchases 70 percent of the outstanding stock of T for 700. The remaining 30 T shares have been held more than five years by Ms. K. T long has operated two businesses, respectively the H Division worth 800 and the W Division worth 200. The H Division, burdened with little recapture potential, has a net asset basis to T of 300. The accumulated E&P of T is substantial. On January 2, 1983, in a transaction correctly denominated a partial liquidation, T distributes the H Division to its shareholders, 70 percent to P and 30 percent to Ms. K, in retirement of 80 percent of the T shares held by each of them. P and Ms. K form a partnership through which to conduct the H business. By reason of the distribution, the remaining value of T is 200 and the value of the T shares retained by P is 140. In November of 1983, P sells its remaining T shares for 140 to an unrelated purchaser.

While the distribution gives rise to capital gain to Ms. K under section 302(b)(4), that provision does not apply to P corporation. Instead, the distribution is an in-kind dividend to P of 210 (70 percent of 300). Enjoying a section 243 deduction P incurs maximum tax liability of 14.49, and under section 301(d)(2) the basis of the distributed assets remains unchanged. Other than a small amount of recapture tax, T recognizes no gain on the distribution in partial liquidation. Section 311(d)(2)(A) applies with respect to the distribution to P, and section 311(d)(2)(B) applies with respect to the distribution to Ms. K.

The flaw in the statutory scheme relates to the basis at which P holds its retained 14 T shares. Because the partial liquidation distribution to it was treated as a dividend, the 700 basis at which P held its 70 T shares pre-distribution is also the basis at which P holds the retained 14 T shares after the distribution. Thus, when P sells those T shares in November, 1983, although P has in fact suffered no economic loss in the series of transactions P will be awarded a short-term capital loss of 560 (700 total basis less 140 sale proceeds). To round out the picture, if in 1981 P recognized, and paid tax of 257 upon, a short-term capital gain of 560, P now will carry back its 1983 capital loss and recoup 257 from the Treasury.

Example (24). The facts are the same as in example (23), except that the H business is operated through H Corporation, a wholly owned subsidiary of T, and K Corporation rather than Ms. K personally owns 30 percent of the stock of T. H Corporation is capitalized with two classes of stock, 100 shares of voting common stock worth a total of 700 and 10 shares of non-voting preferred stock worth a total of 100. On January 2, 1983, T retains the H perferred shares but distributes the H voting common shares pro rata to the T shareholders, 70 H shares to P and 30 H shares to K Corporation. In the hands of T immediately prior to the distribution, the H common shares had a basis of 200.

P and K Corporations pay little tax on the dividend distribution to them of H common shares, and T incurs no tax liability upon that pro rata distribution whether or not any T shares are retired incident to the distribution. Because T retained the H nonvoting preferred shares, it did not distribute "control" of T within the meaning of section 368(c) and thus section 355 did not apply to the transaction. As a result, after the distribution P holds its T shares (worth 210) at a basis of 700. On P's sale of the T shares for 210 ten months later, P recognizes a short-term capital loss of 490. The loss is recognized even though P has suffered no economic loss at all on the series of transactions.

While it is true that a similar problem of "isolating shareholder basis" is presented in every inter-corporate distribution of appreciated property, arrangements of the sort described in the preceding examples—loosely, distributions that would be described in subparagraph (B) or (C) of section 311(d)(2) were P a non-corporate shareholder holding qualified stock of T—merit special attention simply because they offer an opportunity of unusually large tax avoidance. And it is hardly irrelevant that, prior to TEFRA, that opportunity did not exist in a partial liquidation. Under prior law P was required, in example (23), to offset 560 of its T stock basis (80% times 700) against the distribution, leaving P with a basis of 140 in the retained T shares and assuring that, on the subsequent sale by P of those shares for 140, P would recognize no loss.

An encompassing "basis" revision presumably is beyond the scope of a Technical Corrections Act. But a "basis" amendment tailored to the example cases is not inevitable outside the scope of the Act. It is strongly urged, therefore, that for these two classes of cases the statute be amended to expunge from P Corporation's basis

in its T stock an amount that bears the same relation to total basis that the value of the property distributed to P bears to the total value of the T shares held by P immediately prior to the distribution. In the partial liquidation case, the expunged basis should "disappear." In the case of a distribution of stock of a T subsidiary, the expunged basis either should "disappear" or should be added to the basis at which P holds the distributed shares (of H Corporation), up to but not in excess of the fair market value of that property, for purposes of determining future gain (but not loss) on P's subsequent taxable disposition of the distributed shares.

T3C. Section 338

1. Transitory P Corporation: The signal achievement of Congress in enacting section 338 was the substitution of an explicit tax election for prior law's cumbersome "election by liquidation."

In the too brief legislative process that brought forth section 338, it was recommended that the provision be liberalized to permit a non-corporate purchaser (or purchasing group), acquiring control of a target corporation, to file a section 338 election. The proposal was not adopted, it is understood, solely because extending the section 338 permission to a non-corporate purchaser appeared to require extending to that person the burden of the section 338 (e) and (f) consistency requirement. Neither Congress nor anyone else wished to impose that burden on individual buyers.

These two notations set the framework for considering the following example.

Example (25). Mr. B wishes to purchase the business of T Corporation, step-up asset basis to fair market value (and pay attendant recapture tax costs), and operate the business in corporate solution. Because of required landlord consents and the like, the assets of T are not conveniently transferrable whether by deed or by operation of law (i.e., the merger of T into another corporation). Section 338 furnishes the means. Mr. B organizes P Corporation on June 15, 1983, and, on July 1, 1983, P purchases all of the stock of T paying 1000 (which amount Mr. B has invested in P). P immediately files a section 338 election.

So far in the example case, there is no problem. And there will be no problem if P and T continue there respective corporate existence filing (or not) a consolidated return.

But the maintenance of two corporations may not make economic or commercial sense, and may not be possible if, for example, P obtained part of the purchase funds from an institutional lender and the lender insists that P and T be combined into a single corporation so that the assets of T may stand direct security for the loan.

If Mr. B wishes to or is required to eliminate one of the corporations, as a matter of state corporate law he has three choices. First, he can simply liquidate P, recognizing no gain on the liquidation because of his full basis in the P shares, and thereafter own directly the T shares. Second, if corporate combination is preferred (or required by a lender), he can cause P to merge "downstream" into T, exchanging his P shares in the merger for what then will be all of the outstanding stock of T. The "downstream" merger will be tax-free under Rev. Rul. 70-223, 1970-1 CB 79. Third, Mr. B can cause T to liquidate, conveniently by a short-form "upstream" merger into P, following which P will hold the former T assets and conduct the former T business. The liquidation of T into P will be tax-free under section 332; P will inherit the corporate attributes of T under section 381(c); and in the hands of P the former T assets will retain their basis (stepped-up by reason of the section 338 election) pursuant to section 334(b)(1).

Of these three ways of accomplishing the same result—the simplification of a two tier corporate structure—the one way that is commercially unattractive, and in a given case may be commercially unavailable, is the third, the liquidation of T into P. It is unattractive, and may be impossible, because it requires transfer of the T assets. At best that liquidation attracts costs and fees, and perhaps local taxes, that in some cases may be heavy and in all cases yield no benefit to the enterprise. At worst the liquidation may be impossible: required consents of landlords and patent holders and others are not forthcoming or, if available, require a confiscatory increase in future rent or royalty payments. The liquidation of P, or the "downstream" merger of P into T, on the other hand, avoids all of these problems and is entirely consistent with the Congressional aim in enacting section 338: to afford a stepped-up basis for the T assets without requiring an actual transfer of those assets.

Unfortunately, while it is clear that the commercially undesirable liquidation of T into P is permissible following a section 338 election, it is not clear that P's section

338 election for T will be effective, if, within a short time following the acquisition date, either P is liquidated or P mergers "downstream" into T.

The concern arises from the so-called "step transaction" doctrine. If P, newly organized to purchase the T shares and file the section 338 election, promptly goes out of existence, under the step transaction doctrine it can be argued that the transitory existence of P should be disregarded and the overall arrangement treated as if Mr. B, an individual, purchased the T shares directly from the orginal seller. In that circumstance, no section 338 election would have been available.

Certainly it would make no sense to apply the step transaction doctrine as a consequence of the prompt liquidation of P or its prompt "downstream" merger into T. As pointed out at the outset, Congress in enacting section 338 required a corporate purchaser in order to grant a benefit to individual buyers, an insulation from the "consistency requirement." Congress did not instruct that the corporate purchaser, to the economic disadvantage of its individual shareholder, must maintain separate corporate existence for some indeterminate time. And certainly Congress, having eliminated prior law's requirement of an actual transfer of the T assets, did not intend to reinstate that burdensome requirement as a condition of allowing a two-tiered corporate structure to be simplified.

Nonetheless, a very real uncertainty persists. To no sane purpose, taxpayers currently are inhibited from adopting a sensible commercial course, and forced either to incur the burdensome and useless costs that attend the liquidation of T or to maintain an expensive and unnecessary two-tier corporate structure (if the lender permits), because they cannot with safety do otherwise.

What is urgently needed is a clear statement from Congress. In a simple declarative sentence added to section 338, or inserted in the Committee report accompanying the Technical Corrections Act, Congress should announce to taxpayers and the Treasury Department that, while only a corporate purchaser can make a section 338 election, there is no requirement that the corporate purchaser maintain its separate corporate existence following the acquisition date.

Congress has no reason to hesitate. In the Report of the Senate Finance Committee that accompanied the TEFRA enactment of section 338, it was pointed out that the purchasing corporation may file a valid section 338 election and, either before or after the filing, transfer the target corporation shares to an affiliate. If P's continued ownership of the T shares is not a requirement of section 338, there is hardly a good reason why P's continued separate existence should be thought a requirement of section 338.

2. Reversing the inadvertent repeal of section 341: An instructive example of the complex interworkings of subchapter C:

Example (26). On January 1, 1982, T had outstanding 100 shares of voting common stock. At that time T was worth 1000. Mr. A owned 50 shares at a total basis of 50. His mother, Mrs. B, owned 30 recently inherited shares at an aggregate basis of 300. Five unrelated employees each owned 4 shares at an aggregate basis of 10 each. T was a collapsible corporation and no exception in section 341(e) operated to benefit Mr. A. On January 2, 1982, having decided to reduce substantially his commitment to the business, Mr. A caused his 50 T common shares to be exchanged (tax free) for 50 shares of T non-voting preferred stock (worth 500). In June of 1983, T was approached by P Corporation which sought to purchase the T business. After negotiations, on July 1, 1983, P purchased from Mrs. B and the employees all of the voting common stock of T paying Mrs. B 300 and each employee 40. Mr. A refused to sell his T preferred shares to P. P filed a section 338 election. In September of 1983, P succeeds in purchasing Mr. A's T shares for 500. Mr. A recognizes gain of 450 on that sale.

Although T was a collapsible corporation on the acquisition date, and section 337 does not ordinarily apply to a collapsible corporation, that a provision was applicable to "old" T's section 338 deemed sale of its assets to "new" T. Section 341(a), designed to convert shareholder long-term capital gain to ordinary income, did not apply to Mrs. B's sale of her 30 T shares since her basis in those shares was not less than the selling price. Since none of the employee shareholders owned more than 5 percent in value of the outstanding T stock, on their sale of shares to P each of them recognized long-term capital gain pursuant to the "five percent limitation" contained in section 341(d)(1). Each of these results is comprehensible.

What is not comprehensible is the tax treatment present law affords Mr. A. Had he sold his non-voting preferred stock to P on the acquisition date, under section 341(a) his gain of 450 would have been ordinary income. Because Mr. A's sale was deferred until after the July 1, 1983, acquisition date, has gain is long-term capital gain.

This transmutation, from ordinary income to capital gain, under present law is mandated by the section 338 election. From and after July 2, 1983, the basis of T's assets has been stepped-up to fair market value and there is no net unrealized appreciation in them. Thus, whether or not T as a technical matter remains a collapsible corporation as that term is defined in section 341(b)(1), because there is no net unrealized appreciation in the assets of "new" T section 341(e)(1) inevitably applies to insulate Mr. A from ordinary income treatment.

Obviously, a swift technical amendment is required. Perhaps the cleanest approach would provide that, solely for the purpose of determining the applicability of section 341 to a T shareholder (or a donee or other carry over basis transferee of a T shareholder) selling or exchanging T shares within one year following the acquisition date, the section 338 election that has been made (or deemed made) for T shall be disregarded. The rule need not be applied after one year; if P has not purchased the shares within one year following the acquisition date, section 338(c)(1) "surrogate tax" will have been imposed on "old" T. As section 341(f) makes clear, ordinary income tax is imposed on shareholders of a collapsible corporation as an alternative to corporate level recognition of gain. If T bears "surrogate tax" derivative of the T shares retained by Mr. A, there is no reason to impose ordinary income treatment on him as well.

3. Estimated tax; The Bill's otherwise attractive proposal to extend the section 338 election period, from 75 days after the acquisition date to the 15th day of the ninth month beginning after the month in which the acquisition date occurs, exacerbates a significant problem under present law.

Example (27). On September 20, 1983, P purchases from Mr. A all of the stock of T Corporation. Although P and T are both calendar year corporations, P does not file a consolidated return. Initially, P is not clear whether the recapture tax costs of filing a section 338 election will overwhelm the advantage of a step-up in asset basis. After extensive study, on June 1, 1984, P files a section 338 election for T.

The filing of the section 338 election for T in 1984 retroactively closes on the acquisition date the taxable year of T that began January 1, 1983. Under present law, it appears, T is retroactively in default of timely payments of estimated tax and owes non-deductable penalties. Indeed, it would also appear that even if P, in great prudence, had caused T to volunteer a large tax payment before the close of 1983, non-deductable penalties would not be expunged.

This is not an acceptable state of affairs. The unfairness is manifest and the tax law can ill-afford to generate the understandable hostility a rule of this sort must elicit. It is fair to impose an interest charge when P, postponing election, retroactively secures for T the tax advantage of a stepped-up asset basis. It is not fair, or at the least it will not be preceived fair, to impose non-deductable penalties as the price of permitting P to use the study time Congress has granted.

At a minimum, a provision should be added to the Technical Corrections Act authorizing the Treasury Department to promulgate regulations under which penalties, estimated tax and any others, will be waived consequent upon the payment of appropriate interest.

III. A COMMENT ON PROCESS

The Technical Corrections Act does not address the many problems that arise when section 338 is applied across national boundaries. The reticence is becoming. The problems are great, some nearly intransigent, not easily susceptable of merely "technical" correction, and ought to await Treasury's attempt to work them out through the use of its broad authority to regulate.

On the domestic side, the Act correctly identifies most of the TEFRA subchapter C provisions requiring technical correction and, in the main, proposes sensible change. As this submission urges, some additions and expansions appear appropriate, in a few cases necessary, and there is in addition a need for clarification and Congressional direction that can best be furnished through a well articulated Committee report.

The Committee faces this morning an unusually long list of important technical corrections to a rather short list of subchapter C provisions. The Committee does not, however, this moring face a complete catalogue of the revisions that ought to be made in the TEFRA subchapter C legislation because, to address the balance adequately, wholesale conceptual and not merely technical amendments are required. A prime candidate for that sort of change is the unfortunate, inordinately complex "consistency requirement" of 1982 enacted subsections (e) and (f) of section 338.

The need in 1983 for swift and extensive changes to TEFRA's corporate tax provisions is a comment on the tax legislative process. Some of the corporate tax con-

cerns Congress addressed in 1982 were serious concerns that deserved swift attention and clean resolution. Other concerns, some serious and some secondary, called for a careful balancing of competing values, implicated potentially great complexity, and could be satisfactorily resolved only through a thoughtful and of necessity deliberate legislative process.

The legislative process employed in 1982 was not deliberate. It began and ended in 104 days. During that time the tax writing committees devoted the great bulk of their attention to other things. Important corporate tax changes, notably the amendments to sections 304 and 306, were never the subject of any hearing on the House side. The Senate Finance Committee did not hold its hearing on the subchapter C provisions until after that Committee had adopted them. Significant changes, mostly for the better, were made in Conference at the final hour, but there was not and could not be any sort of careful, critical review of what ought to have been done and what had been done, of what would work and what would not, at that last moment.

There is a great need to coordinate, rationalize, and substantively simplify the corporate tax law, as there is a great need to do these things throughout the tax law. The Technical Corrections Bill should be quickly enacted because the errors and oversights of past process must be quickly repaired. But, in the future enactment of new tax legislation, there is an overwhelming need for this Committee and the Finance Committee to embrace a more deliberative legislative process.

The Nation is drowning in tax legislation. Lawyers and accountants and revenue agents, let alone taxpayers, cannot begin to keep pace with the expanding volume of complex new laws. The few slowly developed, carefully crafted, and very welcome statutes that aim at simplifying the tax law, notably the 1982 Subchapter S and the 1980 Installment Sales Revision Acts, are overborne by a stream of ill-starred enactments that deserved but did not receive far greater care and caution in the gestation.

The process is the reality. A hasty tax legislative process rarely if ever produces a satisfactory legislative product. A substantively inadequate, unworkable, or overly intrusive enactment engenders hostility, disrespect for the taxing system, and full employment for tax lawyers and accountants who, more often than not, find ways around the new restrictions and means to exploit new loopholes inadvertently opened.

I truly believe Congress, the tax bar, and the generality of taxpayers are at one in desiring a workable, efficient, and fair taxing system. In attempting to achieve that millennial goal, Congress must play the first and largest role. The history of recent tax enactments, well indicated by the length and breadth of the Technical Corrections Act that is before this Committee today, furnishes deep instruction.

In developing new tax legislation, it is time to go slow.

Mrs. KENNELLY. The Thompson publishing group; the next witnesses are Richard Thompson and Jerry Huss.

Well, then, we will go on to the next panel. Would Joel Feldman of the Employee Stock Ownership Association and Stanley Siegel, Parker & Rutstein come forward?

STATEMENT OF LUIS GRANADOS, MANAGING DIRECTOR, EMPLOYEE STOCK OWNERSHIP ASSOCIATION, ON BEHALF OF JOEL FELDMAN, COUNSEL

Mr. GRANADOS. Madam Chairman, I am Luis Granados, managing director of the association. I can give Mr. Feldman's statement for him.

The ESOP Association is the national nonprofit association of companies with employee stock ownership plans and we are here to support section 104 of the Technical Corrections Act of 1983 that we believe fills in the cracks between two necessary exemptions from the TEFRA provision for withholding from distributions of qualified plans.

Congress enacted withholding provisions of TEFRA last year and provided an exemption for distributions of employer stock, which

was a very necessary exemption, because when shares of stock are being distributed, there is no cash there to withhold.

When the IRS announced its schedules for the amounts to be withheld, the IRS provided another necessary exemption for de minimis amounts of less than $200. When the amounts get that small, then the amount to be withheld becomes so small that it is not really worth the cost to either side to go through the withholding exercise.

The problem is the typical distribution from an ESOP or a stock bonus plan, tends to fall between the cracks because that distribution is typically a distribution of shares of employer stock plus cash for fractional shares, and that cash can be a very small amount. We are talking $4 or $5 here. But the way the rules are set up, the amount used to compute the de minimis is the amount of the entire distribution.

So if you get $10,000 worth of stock and $4 worth of cash for a fractional share, you have to withhold the $4. That is not only an administrative burden but our members are starting to tell us now that their employees, who are not always lawyers and accountants who understand everything that is going on, they see that $4 was withheld and they think, "Gee, that is great; I am all finished with the IRS now."

In fact, it may be hurting compliance rather than helping it.

The section of the technical corrections bill addresses this in a very logical manner just by saying that we will apply the de minimis $200 amount to the amount of cash in the distribution rather than to the entire distribution and leaves all of the reporting requirements in place to provide the audit trail. And we believe it would carry out the intent of these two exemptions.

Thank you.

Mrs. KENNELLY. Thank you.

[The prepared statement of Mr. Feldman follows:]

STATEMENT OF JOEL FELDMAN REPRESENTING THE ESOP ASSOCIATION

My name is Joel Feldman. I am here today representing The ESOP Association, which is the national association of companies with Employee Stock Ownership Plans ("ESOPs"). We strongly support Section 104(b)(5) of H.R. 3805, the "Technical Corrections Act of 1983."

When Congress last year decided to impose tax withholding on distributions from employee benefit plans, it recognized that certain exemptions were necessary from the broad sweep of the requirements. One such exemption was for distributions of employer securities. (IRC Section 3405(d)(8).) "Withholding" per se is not possible in such a case, since there is no cash to withhold. The IRS created another exemption for lump sum de minimis distributions of less than $200. (IRS Announcement 82-151.) Congress recognized that the amount of revenue it would gain from these small distributions was too insignificant to justify imposing the administrative burden of withholding on employers.

Unfortunately, the most typical distributions from an ESOP fall between the cracks of these two exemptions. Typically, an employee receives his ESOP distribution in the form of shares of employer stock, plus cash for any fractional shares. The employer stock portion of this distribution is exempt from withholding. But in computing the de minimis exemption, the entire value of the distribution is looked to, not just the amount of the cash distributed. In other words, if an employee receives $10,000 of stock and $1.00 of cash for a fractional share, the employer is obligated to withhold the $1.00.

This imposes precisely the burden on employers that was supposed to have been taken care of by the de minimis exemption. Virtually every distribution from an ESOP will involve some cash for fractional shares, except in the rare case where an

employee's account balance happens to be an exactly even multiple of the current share price. Furthermore, these cash distributions will almost always be quite small, except in the occasional case where the per share price is extremely large. In fact, it sometimes happens that the administrative cost of processing the withholding will exceed the amount withheld!

Section 104(b)(5) of H.R. 3805 is carefully drawn to solve this problem without creating loopholes for those who wish to evade withholding. It simply extends the exemption for distributions of employer securities to include cash distributed for fractional shares, so long as that cash does not exceed $200. It would carry out the intent of de minimis exemption last year, by making withholding unnecessary when tiny amounts are involved. And it will leave the reporting requirements of TEFRA in place, so that the IRS will still have the information it needs to enforce the law. (TEFRA Section 315; IRC Sections 6652 and 6678.) We strongly support its adoption.

Mrs. KENNELLY. Mr. Siegel.

STATEMENT OF STANLEY B. SIEGEL, PARKER & RUTSTEIN, PHILADELPHIA, PA.

Mr. SIEGEL. Madam Chairperson, let me thank the committee for the chance to testify.

Let me address my remarks to the pension and profit-sharing plan area. I regard the changes that were enacted last year under TEFRA as having a punative effect against small corporations. In my practice, I have seen an increasing and troublesome trend in the reluctance of small corporations to install pensions or profit-sharing plans and also a more troubling trend in terms of increases in the termination of plans.

I understand that many of the top-heavy provisions of TEFRA were designed to prevent abuses by closely held corporation shareholders of the design and administration of their corporate pension plans. I suggest to the committee that the methodology to achieve a perfectly legitimate goal was not appropriate.

I have noticed in my practice in the last 3 years a dramatic drop in Internal Revenue Service audits of qualified plans. It is the function of the Service to audit a plan not simply from a financial point of view but to see that the nondiscriminatory rules of section 401(a) are applied.

I don't know where the personnel priorities of the service are, but they certainly are not in this area.

Second, I contend and I urge the committee to examine alternative methods of preventing abuse. First, I would recommend that the committee examine a full 100-percent vesting formula mandatory for all plans with, I propose, a 1-year waiting period. This would prevent one of the most dramatic abuses where we have had examples of corporations discharging employees before vesting became effective in their cases. Or, as an alternative to immediate 100-percent vesting, I suggest that the Congress contemplate the possibility of establishing a parallel corporation to the PBGC, a national pension bank in which employees could take their vested interest upon termination of employment and deposit them in that bank until they are reemployed. As a corollary, I suggest a requirement that all pension plans be required to accept, which is not required today, rollovers from employees coming from other employers or other union plans.

It is my point of view that the restrictions of super top-heavy requirements that are in the current statute are unfairly discriminatory against our professional and small businessmen, and I urge

the committee to view with favor S. 1760, particularly the approach to section 72(m), (5), which would eliminate the 10-percent penalty for premature distributions on super top-heavy plans.

My second concern is something that I have not seen addressed any place, even in the literature. It is my contention that the statute as currently written contains age discrimination provisions, and I address the attention of the committee particularly to the statutory provisions with respect to the consequences of continuing employment after age 70½.

There is no rationality that I can find in practice, or in logic for requiring an employee to take this distribution at age 70½, if he is a productive individual. There is no magic to age 70½ any more than there is magic to age 65. What we have here is a provision in the statute as it currently exists, that requires an adverse tax consequence to an employee who has actually not taken any cash distribution from the plan.

If it is the Treasury Department's position that it wants to protect revenues from tax-free distribution upon the death of an employee and remedy the current failure to tax at that occasion, then a provision in the statute should be enacted that the tax should be levied only upon death or upon actual cash distribution.

To require taxation at a specific age, whether it is age 59½ or age 65 or age 70, at any age, seems to me to discriminate on a basis that bears no rational relationship to the tax itself and puts the employee in a highly unfavorable position.

Furthermore, it is my contention that in small corporations this provision is rather easy to avoid by transferring ownership in the corporation and taking distribution relatives and to others who would not be affiliated persons under section 318.

Finally, I would like to address the committee on the issue of what has for practioners become a rather horrendous problem, and that is the Internal Revenue Service's method of handling the temporary regulations, particularly this last occasion where we have had the temporary regulations issued under TEFRA.

As I heard another speaker testify a few moments ago, we have been inundated with tax legislation. Perhaps it is necessary. But what certainly is not necessary is the forced compliance with temporary regulations which are subsequently modified by the Service in a rather substantial manner.

We are forced to draft and act upon a series of amendments to plans to meet the temporary regulations which neither the employers, the trustees, let alone the participants fully understand and which the practitioners, I believe, feel are incongruous, unnecessary, and duly expensive.

It seems to me that we can handle the required amendment procedure to the plans by simply requiring them to have an amendment which requires conformity to final regulations when final regulations are issued. This gives the practitioners, gives the trustees, employers, and others an opportunity to make their views known to the Service. This approach provides the Service an opportunity to review its proposed regulations and public comment and develop a single set of definitive rules upon which all involved can rely without an unnecessary intermediate set of regulations.

It certainly seems to me a fair way to treat everyone involved, being less costly and less burdensome, both for the Government and for the general public.

I thank the committee for the opportunity to present my views.

Mrs. KENNELLY. Thank you, Mr. Siegel.

Do the members have any questions?

If not, thank you for coming today.

[The prepared statement follows:]

STATEMENT OF STANLEY B. SIEGEL, ESQ. PARKER & RUTSTEIN PHILADELPHIA, PA.

Ladies and Gentlemen of the House Ways and Means Committee, first, let me take this opportunity to thank you for the privilege of appearing before you and testifying on H.R. 3805. The Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA") was, in my view, a punitive measure aimed at small corporations, particularly professional corporations. Although I favor a total repeal of Section 416 of the Internal Revenue Code of 1954, as amended, ("IRC"), it does not appear that there is much chance that such a repeal being considered and enacted by the Congress at this time. I will therefore address my remarks to those sections of TEFRA which seem to be most urgently in need of technical correction.

The first area of my specific concern is the attitude of the Internal Revenue Service with respect to temporary regulations. The current practice of the Service is to issue temporary regulations, asking for public comments before issuing final regulations. This is, of course, the normal procedure which the Service is required to follow in the issuance of all regulations. I have no objection whatsoever to this procedure. It is the Service's application to Section 401(a) plans that I object to. Experience has shown that temporary regulations are substantially modified in virtually every case before being issued as a final regulation by the Secretary of the Treasury. However, the Internal Revenue Services has taken the position that all Section 401(a) plans must comply immediately with the temporary regulations in order to keep their qualification. Not only does this result in needless duplication of amendments, additional costs to the employers in administering the plans, but also results in confusion of the employers, and most especially the participants. A far simpler way of dealing with changes in the final regulations would be for employers, in the interim while only temporary regulations have been issued, to adopt short form amendments which merely incorporate any new required qualifications by reference, to be effective on the issuance of final regulations. Once the final regulations are issued, employers should be given a reasonable period of time, say one (1) year, in which to amend the plans to conform to the terms of the final regulations.

I object in general to the "top-heavy" plan concept. I regard it as specifically aimed at debilitating small corporations' pension plans. As I will later elaborate, I have no objection to immediate 100% vesting as part of a vesting reform program which would encompass all plans of whatever size and dimension, whether employer or union sponsored. Until such time as a reform of that nature is forthcoming, I object strongly to the "top-heavy" accelerated vesting schedules which are now required. There is no evidence other than rumor or conjecture that "top-heavy" plans have abused vesting. Indeed, it is the function of the Internal Revenue Service to supervise the administration of qualified pension plans. One such area of supervision which the Service should devote its attention is the abuse of vesting privileges. Furthermore, the courts now provide remedies for the abuse of vesting which I deem to be adequate. I recommend a return to the more moderate "4-40" schedule as opposed to the accelerated current six-year graded vesting formula.

I favor the repeal of Section 416(h)(2)(B). The attempt to neutralize the advantages of combined plans as provided in Section 415(e), to key employees is an example of overkill. Whatever justification there may be for "top-heavy" plans, there is, in my opinion, no justification for "super top-heavy" plans, those plans which provide key employees more than 90% of the benefits. The effect of the Section 416(h)(2)(B) limitations actually works to the detriment of the non-key employees. It prevents the establishment of second plans which are required to provide minimum benefits to rank-and-file employees. The other "top-heavy" rules currently in effect are more than sufficient to provide for the protection of such employees. The pre-TEFRA "1.4" rules are a more even-handed approach to the establishment of dual plans, particularly when minimum benefit levels for all employees are required. Our policy ought to be to encourage the establishment of as many private pension plans as we can, not to discourage them.

I believe that the definition of "key employee" has to be examined with a view to substantial revision. I favor the approach taken in H.R. 3805 which will add a compensation test in determining which employees are the ten largest owners. TEFRA and the proposed Regs create an anomalous situation where a corporation has ten employees who may fall into the "top-ten" category if more than ten of the largest shareholders have equal ownership interest.

With respect to reacquired distributions at the pre-set ages, I favor the general approach of H.R. 3805. I support the proposed provision that would modify the distribution requirements for those key employees in "top-heavy" plans requiring them to take distribution no later than age 70 and ½. I regard this current standard as an example of age discrimination. We are witness to a shift in our population in the age-weighted average and can expect this trend to continue well into the next century. There is no rational basis to require that an individual age 70 and ½ suffer an adverse tax consequence, to be treated as if he retired, when in fact he is continuing to work and to be productive. What is the basis for penalizing with the tax on a distribution not taken, an individual who continues to be productive and continues to work? I think this is one of the most objectionable provisions of the current statute. I do not favor the proposal in H.R. 3805 which would have the Section 401(a)(9) minimum distribution rule still apply if the employee were a key employee in a "top-heavy" plan for the plan year ending in the tax year when the employee reaches age 70 and ½. It is but another example of age discrimination. I believe distributions should be taxed when actually received, only then, and not at some presumed statutory age. I feel that the proper approach for taxation to apply is the doctrine of "constructive receipt". I would call attention of the Committee to the proposed Senate Pension Correction Act of 1983, S.1760, sponsored by Senator Benson of Texas. I believe his approach to Section 72(m)(5) which would eliminate the 10 percent penalty on pre-aged 59 and ½ plan distributions to the employees of "top-heavy" plans is fair. I favor it because it represents a repudiation of the age discriminatory policy of TEFRA. Furthermore, it is also easily avoidable. In a "top-heavy" plan the trustee-shareholder can delay distribution to age 59 and ½ for the key employee involved, or the key employee can avail himself of the loan provisions of his plan to get access to funds, before age 59 and ½, without any penalty. I believe that distribution from a Section 401(a) qualified plan should never carry any penalty with it, whatever age such distribution received, and should only be taxed in a uniform manner, at the tax rate applicable to all distributions.

I object in general to the TEFRA rollbacks of benefit limitations in defined benefit plans to the $90,000 benefit level and with respect to define contribution plans, to the $30,000 maximum contribution. I additionally object to the forebearance of the cost-of-living increases which had been previously allowed until 1986. I will not address myself in detail to the specific basis of such objections rather confining myself to the proposed H.R. 3805 clarification. I do not favor the proposed extension of the actuarial reduction in Section 415(b)(1)(A) in the case of delayed retirement. It amounts to an arbitrary penalty for continuing to work. Further, actuarial reductions for delayed retirements in small closely-held corporate pension plans are unlikely to be efficaious. Retirement ages can be established in such plans and amended as may suit the need of the individual shareholder-trustee with certain minor restrictions. Basically, I favor the encouragement of contribution to qualified plans and I do not favor laws or regulations which further limit either deductions and contributions. It is not a matter of a simple trade-off of when the revenue shall be raised for the Federal Treasury as between reduced contributions and higher revenues immediately or more liberal contribution levels and higher revenues on retirement, rather it is that trade-off as well as the intangible but high significant policy of encouraging independence on the part of our senior citizens in their retirement years. Government at all levels, will benefit both from a revenue producing a point of view as well as from an expenditure point of view by encouraging the maximum financial independence of our senior citizens. It has been clearly established that senior citizens as a group, legitimately, require a disproportionate amount of government expenditures as compared to the rest of the population. A policy which favors their financial independence would have the unending beneficial consequence of requiring lesser government expenditures. Such a policy combined with the shift of our population to the older ages, in the forthcoming decades, will mean that more and more of our senior citizens will have the dignity of financial independence.

I think it incumbent upon me at this point to set forth the basis in which I feel that a total repeal of Section 416 should be entertained by the Congress. The pension reform provisions of TEFRA throw the baby out with the bath water. That is to say, employees of small businesses are substantially disadvantaged as compared to the employees of large enterprises and unions by the anti-small business provisions

of the statute. In my practice I have seen a marked reduction in the formation of pension plans for small corporations, particularly professionals. I have experienced a startling and unfortunate increase in the proposed terminations of the plans of small businesses. The key employees of small corporations will undoubtedly find other means by which to shelter income whether tax shelters or deferred compensation not available to their employees. The pension provisions of TEFRA cannot be defended as a revenue-raising measure for two (2) reasons. First, the amount rasied has never been shown by the Treasury to be significant. Second, a proper approach to revenue-raising in the pension area ought to be directed to a review of the tax-favored distribution rules, such as the ten-year averaging rule, rather than focus upon inhibatory qualification requirements for the establishment of pension plans. A revision of the formula for taxation of the distributions from qualified plans will produce far more revenue than is produced by the imposition of burdensome qualification requirements to old and new qualified plans. Some have maintained that the purpose of TEFRA is neither punitive action against small corporations nor revenue raising but rather the protection of the employees of small corporations from the abuses of key employees. To the extent that higher paid individuals are benefited with higher contribution, and to the extent that shareholders establish and control the appointment of trustees, such individuals will continue to get a higher amount of contribution for themselves compared to lower paid employees. This is an inevitable and justifiable result of a capitalist system and a private pension system. However, where there have been substantial abuses by key employees, they can be remedied by a change in the vesting provisions which would be a part and parcel of the total portability approach which I advocate. In my view, vesting should be immediate and 100 percent. Congress ought to require either all plans accept rollovers and employees leaving a preceding employer's or union's plan or that a national vesting bank be established where employees can deposit their rollover funds and eventually draw on them for retirement.

It is my view that the pension provisions enacted by TEFRA were ill-advised. Federal tax policy should be directed to the maximum encouragement of the establishment of pension plans and the maximum contribution thereto. We are making an investment in our senior citizens and ourselves. We are making an investment in their financial independence and in reduced Federal expenditures on their behalf.

I recommend that the Committee consider a long-term study of the benefits of our private pension system as a supplement to social security in light of a comprehensive development of a tax policy designed to promote such benefits as provided by the pension system. Current laws and regulations which aim to penalize small corporations take a blunderbust approach. Such policies serve neither equity or revenue raising goals. Discrimination in favor of key employees can be handled under the proper audit procedures of the Internal Revenue Service, which has wide powers to disallow the qualification of a plan based upon discrimination. Not only do some of our most productive citizens, the owners and proprietors of small businesses, feel the adverse impact of this discriminatory legislation but the Congress has penalized their employees, as well, by discouraging the establishment of new plans and the reduction of contribution levels.

Mrs. KENNELLY. National Association of Police Organizations, Ira Lechner; International Association of Firefighters; Employees Retirement System of Texas.

Mr. Schaitberger, would you lead off?

STATEMENT OF HAROLD A. SCHAITBERGER, DIRECTOR, DEPARTMENT OF LEGISLATION AND POLITICAL ACTIVITY, INTERNATIONAL ASSOCIATION OF FIREFIGHTERS, ACCOMPANIED BY HARVEY SCHMIDT, PRESIDENT, NATIONAL CONFERENCE ON PUBLIC EMPLOYEE RETIREMENT SYSTEMS

Mr. SCHAITBERGER. Yes, Madam.

Madam Chairwoman and members of the committee, first I would like to introduce the gentleman who is accompanying me today, Mr. Harvey Schmidt, who is the president of the National Conference on Public Employee Retirement Systems. I would ask that the committee consider the comments that I will make in

behalf of the International Association of Firefighters as reflecting the views of the national conference.

I would also ask if our formal statement, which we have provided to the committee, could be entered into the record. And I would be more than happy to give a brief summary resume of our remarks.

Mrs. KENNELLY. The entire statement will be entered into the record.

Mr. SCHAITBERGER. First, we commend the committee for the introduction of H.R. 3805, particularly in an area which we have a grave concern with, which was enacted in the TEFRA Act of 1982, that being in section 235 and 242 concerning the distribution of benefits to dependents of retirees.

But first let me just try to mention three general areas that we still believe give us great concern and we would ask the committee to give consideration to further refinement to the technical corrections bill.

The first is in section 235 in the provisions of TEFRA which reduce the limitations on benefits and contributions to qualifed pension plans. We believe that a further technical correction is justified even though the substance of the bill would be altered, because we believe it was a technical mistake which has created a severe pratical problem for two particular professions—that is, individuals engaged in firefighting activities and law enforcement activities.

We understand and our feeling is the intent of Congress in reducing these limitations was to try to prevent those who might want to protect the sheltering of income by placing that income in qualified pension plans for distribution at early ages, ages earlier than what is considered normal retirement ages.

But in reducing those limitations and then taking into account the further actuarial reduction of those limits for each year that an individual would retire prior to age 62, the practical impact is to severely restrict the normal retirement income received by those in firefighting and law enforcement activities who generally and normally retire prior to the age of 62 and certainly often prior to the age of 55.

These limitations, although they would have very little practical impact to many individuals in private industry and particularly high income professionals, could have a disastrous effect on those engaged in public safety work. Those that enter into the public safety field realize that the physical and mental demands and stress generally have qualified and justified normal retirement which retires individuals with 20, 25 years of service very often at ages of 45 or 50 years old.

The impact of this provision is to place an artificial cap on the amount of retirement that these individuals may be able to receive as normal retirement benefits, and thus could jeopardize the qualified tax status of their public plans.

So we would ask the committee to take a serious look at the possibility of either exempting the effect of that particular limitation to fire and police plans or at least to further refine the actuarial formula so that the reductions which occur at the early ages would for all practical purposes not impact those in the public safety field.

The second area we would like to bring to the committee's attention is the section 242, which placed a limitation of 5 years on the distribution of benefits to individuals who would be entitled to those distributions from retirees and public plans, that being nonspouse benefits. Again we have a practical problem and it is obvious that the committee and the chairman have taken a joint step forward in trying to rectify that problem. But again, we have some suggestions as to further refinement.

The practical impact again is quite serious. Restricting the distribution of nonspouse dependent benefits could have a disastrous effect on the hundreds of individuals and particularly dependent children of members who may be left at very young ages with lifetime survivorship benefit payments. With the limitation to 5 years, we could easily find ourselves in a situation where young children, dependent mothers and fathers, dependent brothers and sisters and incompetent children may be left without any survivorship benefit at all.

In the back of our testimony, as a help to the committee to take a real look at the problem, instead of just trying to give theoretical examples we have given you real life examples which we have obtained from the Ohio retirement system with their assistance of individuals who are now receiving survivorship benefits who, under the current provisions of 242, would be left without protection and without those benefits beyond the 5-year limitation.

I mentioned that 3805 did take into account and recognized that there was a problem here, but again we would still like to offer suggestions for further refinement.

Currently, 3805 would allow the exemption of a qualified dependent from those provisions. However, the description of qualified dependent would restrict that individual to someone under the age of 22 years of age or disabled. We think that there are several other true individuals that would be entitled to be considered as qualified dependents and that should cleary be the dependent child of any member entitled to benefits that is either under the age of 18 or is in school, as would be described under section 152.

We want to assure that incompetent children would be considered qualified dependents and incompetent very often must be determined by a judge in an appropriate jurisdiction or many times by medical personnel who represent the individual pension plans.

We also want to insure that those dependents which do not fall under age 22, disabled or incompetent would be contined as entitled to receiving the benefits such as dependent parents or dependent brother and sister. Again, I think you will see in our examples there are many individuals who now receive these benefits who deserve these benefits and they should be allowed to continue to receive them.

The last item that I would like to mention is a time for implementation. In enacting these provisions, those plans in the private sector have the capability of making adjustments required by the Congress within themselves. However, when we are addressing plans in the public sector, many of our plans are contained in State constitutions. Many of our plans require action by State legislature and many are included in city and county charters.

I have a list of examples of those State legislatures that meet only once every 2 years, many in the odd years and some in even years. Our point is that we would ask that the extention which is included in H.R. 3805, which would extend it 1 year, be extended an additional year to allow State and local legislative bodies the necessary time to implement any necessary changes required.

With that, I would like to thank you for the opportunity to have presented our views today.

[The prepared statement follows:]

STATEMENT OF HAROLD A. SCHAITBERGER, DIRECTOR, DEPARTMENT OF LEGISLATION AND POLITICAL ACTIVITY, INTERNATIONAL ASSOCIATION OF FIRE FIGHTERS

Mr. Chairman, members of the Committee, my name is Harold A. Schaitberger and I am Legislative Director for the International Association of Fire Fighters (IAFF), AFL-CIO-CLC, which represents approximately 175,000 professional fire fighters throughout the United States and Canada. I am pleased to appear before the Committee today to express our views on HR 3805, the Technical Corrections Act of 1983. More specifially, I will be addressing my comments toward Title I of the Act.

While the IAFF is in general support of Title I, which seeks to rectify what were inadvertent inequities that resulted from the passage of the Tax Equity and Fiscal Responsibility Act (TEFRA); we do have specific recommendations to make in two areas that we feel HR 3805 does not address adequately. Those areas are TEFRA's pension qualification requirements for early retirement benefits found in Section 235, and its requirements for the distribution of pension benefits to surviving dependents found in Section 242.

A major intent of Section 235 of TEFRA was to prevent high salaried individuals from reaping unfair and untaxed financial gains by retiring at early ages, after contributing large amounts of money into defined benefit plans and, thereby, avoiding the payment of federal taxes on the capital those contributions would generate. Section 235, therefore, actuarially reduced retirement benefits for those retiring prior to age 55, in order to discourage individuals from using their retirement plans for such purposes and from receiving unnecessarily high pension benefits at an early age. However, there are two major professions—fire fighting and law enforcement—that provide early normal retirement benefits as a matter of course and whose benefit levels may bump-up against the actuarial limits established in TEFRA, leading to a reduction in pensions received prior to age 55, if the plans are to maintain their exempt status.

We must note that many fire fighter and police pension plans provide for retirement prior to age 55, since they take into account the need for a young and vigorous workforce for the performance of the duties required by these professions. Retirement before age 55 by fire fighters and police officers provides a vital recruiting tool and can in no way be described as the kind of abuse of the tax structure that the actuarial limits of Section 235 sought to prevent. We, therefore, recommend that amendments to Section 235 be made, which would raise these limits for those in the fire fighting or law enforcement professions, or which would exempt fire fighter and police pension plans from those limits.

Section 242 of TEFRA placed new restrictions on the distribution of an employee's pension interest to surviving dependents, restricting that distribution to a period of no longer than five years. As a result, if an employee and his spouse were to die leaving an eight year old child, benefits to that child would have to be distributed within a five-year period, that is, by age thirteen. The five-year restriction applies to all surviving dependents, including parents and incompetent children.

HR 3805 does address the inequity of this time restriction by allowing the distribution of pension benefits for a period longer than five years after the participant's death if the beneficiary is a dependent (within the meaning of Section 152 of the Internal Revenue Code) who is under the age of 22 or is permanently and totally disabled. However, we feel this language should be further refined to assure that all truly dependent survivors continue to receive needed benefits after five years.

We, therefore, recommend that line 4, page 31, of HR 3805 be amended to read: "(I) is under the age of 23, or"; and that the following be added after line 7, page 31:

"(III) is found to be an incompetent child (as determined by a court of jurisdiction or a physician approved by the appropriate retirement board of the plan).

"(IV) is a parent, brother or sister of the employee who was a dependent for federal income tax purposes as defined in Section 26-152(a) U.S. Code for the taxable year in which the employee died."

We are providing a list of individuals eligible for survivor's benefits under Ohio's retirement plan, whose benefits would be lost if this recommendation is not accepted. We believe the list is representative of the situation all over the country, and ask that it be included in the record of our remarks.

HR 3805 also delays TEFRA's effective date for the pension distribution requirements as they relate to government retirement plans in order to permit enough time for the States to conform their statutes to these pension changes. With many state legislatures only meeting every two years, and since many public pension plans are governed by city charters, as well as state constitutions, we feel that additional transition time should be provided for implementing the changes. We, therefore, recommend that lines 4 and 5, page 32, be amended to read: "of the first play year beginning on or after January 1, 1985."

I would like to thank the Chairman and the Committee for allowing me to appear before you to present the views of the IAFF and its membership on HR 3805.

BENEFITS THREATENED BY SURVIVORSHIP BENEFIT LIMITATIONS OF TEFRA

Leisa B. Weiss: dependent 20 year old daughter of Glennis E. Hall (deceased), attending school.

Carl M. Gottschalk: dependent and incompetent son of Margaret F. Gottschalk (deceased), age 29 and adjudged to be incompetent.

Tamara Breenan: dependent minor granddaughter of Crystal Hovey (deceased).

Elizabeth Cox: dependent mother of Angeline C. Bond (deceased).

Rose Andorka: dependent sister of Virginia A. Thompson (deceased), Rose was age 56 at the time of her sister's death and unmarried.

Gladys McKinley: dependent aunt of Marcella M. Ickes (deceased), her age is 78.

Katherine Peck: a 90 year old dependent mother who would be eligible for a survivors benefit upon the death of her daughter Olive S. Peck.

William Parker Furnas: a 19 year old son of Esther M. Furnas, who would be eligible for survivors benefits upon the death of his mother, Esther M. Furnas.

Charles Tracy Johnson: suffering of a birth injury and eligible for survivors benefits upon the death of his father, Harold N. Johnson. Charles is 39.

Thomas Blair Jarrett: son of J. T. Jarrett, he has been mentally retarded from infancy.

Sharon A. Guttenberg: currently receiving benefits from her mother's account (Theresa M. Guttenberg (deceased)), Sharon was age 19 when her mother retired and she is retarded. She lives with her father.

Patricia S. Swinney: currently receiving benefits from her great-aunt's account (Hazel Z. Painter, deceased). Hazel's relatives denied the existence of Patricia for a period of time.

Myrle E. Witker: dependent mother currently receiving benefits.

Mrs. KENNELLY. Thank you, Mr. Schaitberger.

Mr. Davenport.

STATEMENT OF EVERARD C. DAVENPORT, GENERAL COUNSEL, EMPLOYEES RETIREMENT SYSTEM OF TEXAS

Mr. DAVENPORT. My name is Everard Davenport. With your permission, I would like to enter my full remarks in the record and summarize them briefly.

Mrs. KENNELLY. Without objection.

Mr. DAVENPORT. The Teacher Retirement System of Texas and the Employees Retirement System of Texas asked me to come up here because we have about half a million people that are covered in plans that would be affected by section 242 of TEFRA and the proposed amendment in the Technical Corrections Act, section 103(g). We have many of the same problems that were described by the previous witness.

I think, as a practical matter, the circumstances in public plans differ substantially from those where abuses existed that Congress

was attempting to address. First there is no tax advantage to our employers to put large sums of money into our pension plans. They are not deferring any taxes because they owe none.

The second is the public employees simply don't have that much money. Half of our retirees' gross income is such that if they are living on our benefits and social security, they don't have to file Federal income tax returns. Our average annuity is under $450 a month.

People that are living on that much money are not playing games with their pension plans when they waive benefits irrevocably for the rest of their lives to provide survivorship annuities.

I spent 5 years as director of the retirement division and in that time I talked to a good many people who were choosing third party beneficiaries, a person other than their spouses, to receive benefits after they died. I never saw one of those cases where the person did not use what I considered at the time good judgment. They were covering ex-spouses, which are not covered in this, toward whom they either felt moral responsibility or had a legal responsibility required by valid divorce decrees. They were talking about aged parents. They were talking about siblings that would be mutually dependent. This would be particularly true, let's say, in the case of three unmarried or widowed schoolteachers who might be living together.

Oftentimes these people are not even dependents in the sense that the word is defined in the IRS Code. You can have a parent that is living on social security and maybe a small pension. They have too much money to be covered by medicaid but they are living in a nursing home and somebody has to make up a difference of $200 or $300 a month. And that $200 or $300, while it is not more than half their support, is absolutely necessary to those persons.

What we discovered is that the people that came to our office and made these decisions simply did not make decisions that were not sound and reasonable under facts as they existed at that time. They were not making selections to do anything other than to insure that people to whom they had moral and financial responsibilities would be adequately taken care of.

Now, the issues that Congress has addressed are not funding issues for the pension plans. They don't make any difference in the cost of the plans. They are not revenue issues to the Federal Government because the money involved is comparatively small, instead they are policy and basic fairness questions that have to be addressed by this committee.

Whenever Congress is telling retiring employees that they can not make decisions about who their beneficiaries are going to be, there should be a good public policy reason. And where Congress has found cases of abuse, any remedial restrictions should be limited as much as possible, to prevent unnecessary infringement upon employee's rights to protect those persons for whom they are responsible.

Obviously I feel the public plan should not be covered at all under section 242. If, though, it is necessary that Congress does cover public plans, then the laundry list of accepted persons that was proposed by Representative Rostenkowski should be expanded

to include certainly ex-spouses and preferably other persons such as dependent siblings or the parents.

Perhaps Congress should look at section 152 that lists those persons that are authorized to be dependents under the Internal Revenue Code.

Again, Texas is one of those States whose legislature will not meet until 1985. We cannot possibly comply with 242 even with the 1-year deferral that will be granted by section 103(g).

Finally, if only minor amendments are to be considered, I would request section 242 be clarified as much as possible with the amendments to it proposed by 103(g). I have heard four reasonably competent lawyers come up with four completely different interpretations of that section. The last one I heard yesterday at the Joint Tax Committee I assume is correct, but unfortunately none of the Texas public pension plans had heard of it before I walked in there yesterday.

Thank you very much.

[The prepared statement follows:]

STATEMENT OF EVERARD C. DAVENPORT, GENERAL COUNSEL, EMPLOYEES RETIREMENT SYSTEM OF TEXAS

Good morning. My name is Everard C. Davenport. I am general counsel for the Employees Retirement System of Texas and I am here on behalf of that system and the Teacher Retirement System of Texas. Between the two retirement systems, we cover more than one-half million active and retired State officers, State employees and school teachers. Like most public systems, membership of eligible persons is mandatory; and our members are required to make substantial monthly contributions. Benefits from our systems are paid without regard to contributions but are paid under a formula based on average salary and years of service. I am going to confine my remarks today to section 103(g) of H.R. 3805 and section 242 of TEFRA which it amends.

Prior to the effective date of those two amendments, section 401(a)(9) of the Internal Revenue Code will continue to apply only to persons who are self-employed or owner-employees. It restricts the payment of pension benefits from qualified plans to the lifetime of the owner-employee and the lifetime of his or her spouse. A time certain plan can be selected only if it does not provide for payments for a period of time greater than the life expectancy of the owner and spouse. Apparently, the section is designed to prevent the sheltering of business income by placing it in a qualified pension plan, then distributing it to remote parties.

We have been told that, even though the loophole is closed for self-employed persons, the same problem exists elsewhere, though to a lesser extent.

Congress has taken several steps which directly or indirectly limit such abuses of qualified pension plans. Those steps include:

1. Limiting contribution and benefit levels;
2. Setting comparatively low limits on estate tax exclusions for the proceeds of qualified pension plans; and
3. Adopting section 242 of TEFRA to expand to all qualified plans the 401(a)(9) limits on payments after the deaths of employees and spouses.

Again, I am here to discuss only the last of these—the limitations on payment of benefits after the death of the employee and the employee's spouse. Congressman Rostenkowski has addressed two of the most obvious problems in section 103(g) of H.R. 3805. He has proposed that payments be allowed to surviving dependents if the survivor is incapacitated by either minority or total and permanent disability. We support this needed change and hope that you will consider additional ones, as well.

While we have been told of abuses in some plans which apparently prompted passage of section 242 of TEFRA, we know for sure of inequities which will necessarily result from any restrictions of our own employees' freedom of choice. Of the 100,000 plus annuitants of our two systems, only about 2,400 are persons other than retirees or the surviving spouses of deceased retirees. Nevertheless, with that many people retiring, multitudes of reasons have been given for selecting third parties as beneficiaries. Reasons not mentioned in H.R. 3805 with which I have personal familiarity have been given by:

1. Persons wishing to select an option to assure a lifetime income to an aged parent.

2. Persons wishing to select an option to protect mutually dependent siblings. This is particularly common among sisters who are widowed or who never married.

3. Persons wishing to provide a lifetime income to former spouses, whether voluntarily or under valid divorce decrees.

4. Persons wishing to provide for children of former marriages who no longer live with the member and cannot be claimed as "dependents."

I would emphasize that it is unusual for a third-party designation to be used, but that it is extremely important to the people involved on those occasions.

Persons who retire from public service simply are not wealthy people. About one-half of our annuitants receive enough income from the system to warrant the filing of a Federal income tax return. They certainly don't give up a significant portion of that retirement income to benefit a third party, unless there are sound economic and moral reasons for doing so. During the five years I spent as head of our system's retirement division, I didn't see a single instance of a third party designation which I would not have at least seriously considered under the circumstances.

I urge this committee to leave as mush flexibility as possible to the people whose pensions are involved. Our retirees are remarkably astute when making irrevocable decisions about the benefits they will receive for the rest of their lives. The ones I known weren't playing games or trying to outfox the Internal Revenue Service—they were trying to insure that neither they nor persons dependent upon them ended up unable to afford food, shelter, and the other basic necessities of life.

Another issue which this committee might wish to consider is that of the sex discrimination inherent in this legislation. I understand that there is a clear distinction between sex discrimination when persons of different sexes are viewed as individuals with unknown life expectancies and when they are viewed as members of an actuarial class. Without being a specialist in tax law, it appears to me that IRS can issue either legally permissible regulations under this bill or factually valid regulations, but not both.

The determining factor on "time certain" retirement options is life expectancy. Although the courts have rules that men and women must be treated as if they will live the same length of time, women, as a class, do live longer than men, as a class. If IRS issues sex-neutral life expectancy tables, the average woman will outlive her "life expectancy" by several years—her beneficiaries will never get anything from her pension plan. The average man, though, will die before the expiration of his "life expectancy." His survivors will be paid a significant sum of money from his pension fund.

If section 242 is retained, about the only way IRS can avoid that real discrimination is to issue sex-based mortality tables. Unfortunately, those tables would appear to be in conflict with the view of sex discrimination recently adopted by the Supreme Court.

A final matter for your consideration relates to the dependency requirement of H.R. 3805 for non-spousal survivors. There are many instances where one of our retirees is providing essential financial help—but not a majority of the recipent's support. Examples include those of a retiree making up the difference between her parents' net income and the costs of nursing home care or making child support payments to a former spouse.

This committee has devoted much of its attention to the careful balancing of conflicting demands on the Nation's pension programs. The issue today is not one of funding of the system or of revenue to the Federal Government. Section 401(a)(9) in any of its forms is primarily concerned with public policy. The question to be addressed, then, relates to basic fairness and a determination of the amount of abuse which can be tolerated to permit employees and retirees the right to determine how to best deal with the financial obligations for which they feel responsible both before and after their own deaths.

I suggest that, at least in the area of public pension plans, no real abuses exist. The overwhelming majority of those plans are:

1. Mandatory for all employees.

2. Contributory—employees usually contribute 4 percent to 7 percent of salary.

3. Formula benefit plans which pay comparatively small annuities. Typically, the primary benefit is a lifetime annuity based, not on contributions, but on salary and length of service with all optional plans being actuarially equivalent.

4. Payable only to long-term employees.

5. Scrutinized by the legislature and the taxpayers to prevent abuses.

Finally, and perhaps most importantly, the plans are all funded by tax exempt governmental entities which gain no tax advantage whatsoever from placement of funds in a pension program.

These circumstances make plans, such as ours, totally unlike the one where the qualified pension system is being mistreated. Somehow, though, our employees have gotten caught between the abusers and those of you who must regulate them. We need your help. Clearly, our first choice would be to be exempted completely from all amendments to section 401(a)(9) of the Internal Revenue Code. If that request cannot be granted, then the list of acceptable beneficiaries should be expanded to include former spouses and those persons eligible to be dependents under section 152 of the Internal Revenue Code. For the reasons stated above, we feel that the dependency requirement should be abolished, as well.

In the event that section 103(g) is to be adopted with only minor amendments, please consider the following:

1. The right to cover non-spousal qualified dependents only applies to active employees described in subparagraph (b) of section 242 of TEFRA. The retiring employees described in subparagraph (a) should be covered as well. Otherwise, an employee who feels he must provide for a qualified dependent can't retire.

2. The Texas Legislature and maybe that of other States will not meet again until January 1985. We request that the effective date of application of any amendments to section 401 of the Internal Revenue Code be postponed until January 1, 1986.

Thank you very much for your consideration. I will be happy to try to answer any questions you may have.

Mrs. KENNELLY. Thank you, sir.

We will next hear from Mr. Ira Lechner, legislative counsel for the National Association of Police Organizations.

STATEMENT OF IRA M. LECHNER, LEGISLATIVE COUNSEL, NATIONAL ASSOCIATION OF POLICE ORGANIZATIONS

Mr. LECHNER. Thank you, Madam Chairman, members of the committee.

My name is Ira M. Lechner, legislative counsel for the National Association of Police Organizations (NAPO). NAPO is an association of law enforcement organizations across the country and represents over 50,000 rank and file police and law enforcement officers.

A police officer's pension is dear to his or her heart and I am appearing before the committee today to express the very strongly held views of NAPO's membership about certain pension features of 1982's Tax Equity and Fiscal Responsibility Act [TEFRA), which we hope you will correct in this year's Technical Corrections Act, particularly in title I of that bill.

I will try to be constructive and brief. I will address my comments specifically to section 235 of TEFRA.

Clearly, the Congress reduced or capped the pension benefits received prior to age 62 by plan participants of defined benefit plans or defined contribution plans. The intent clearly was to inhibit certain highly salaried professionals and executives from using their retirement plans as tax shelters by retiring at early ages with high pensions after avoiding paying Federal taxes on large employer contributions to the plan.

Section 235 of TEFRA discouraged this practice by reducing the maximum payable benefit and by mandatory actuarially reduced retirement benefits which results in prohibiting a qualified retirement plan from paying more than $26,741 to a retiree at age 40, or more than $28,457 at age 41, et cetera.

The problem is that by virtue of the definitions of qualified retirement plans in TEFRA, public employees who traditionally

retire with full benefits after 20 or 25 years of service, such as police officers and firefighters, unintentionally were caught by Congress in the antitax shelter web designed not to effect public employees at all.

Indeed, there are many police officers who work under employment rules which require "20 and out". But under TEFRA, the officer would receive less than he has earned in the plan and has a right to expect.

As a result, now there are certain police officers who cannot receive the pension benefits which their own local pension plan provides if they retire early. Certainly, their municipal or State pension system was not one of the tax dodges which Congress meant to discourage.

Moreover, I know you are familiar with the fact that attractive early retirement benefits are an important inducement to persuade young men and women to enter into the lower paid career of law enforcement. But, lo and behold, catch 22 in the form of TEFRA's unintended result now limits their ability to receive those early retirement pensions.

One equitable and rather simple solution would be to amend section 235 to raise the actuarially reduced limits for law enforcement officers and firefighters, or which would simply exempt those public employee pension plans altogether from those limitations.

There is not 1 cent of revenue loss involved by agreeing to either of those amendments as none of the public employers who contribute to these public employee plans are taxable in any event.

A gross and unintended inequity would be resolved by this committee and Congress and those who police the streets and guard your neighborhoods could go about their work without having their locally funded retirement systems adversely affected when the Congress was really after correcting other tax avoidance schemes.

Madam Chairman, members of the committee, the National Association of Police Organizations earnestly recommends that title I of the Technical Corrections Act be amended to raise the actuarially reduced limits for public safety officers, or that such public employee plans be exempted from those limitations. Such legislation has been introduced by Representative Biaggi and Senator D'Amato—H.R. 954 and S. 136—and by Representative Downey—H.R. 1175.

Thank you for the opportunity to express our views.

Mrs. KENNELLY. Thank you, sir.

Do any of the members have any questions? Thank you very much.

I think the Thompson Publishing Group has now arrived. Richard Thompson, president; Jerry Huss, CPA Digest; Tod Sedgwick, Pasha Publications; Allen T. Joseph, counsel.

The committee would like to make note that all written testimony that you have will be entered in the record. You may want to paraphrase your testimony. Mr. Thompson, would you lead off?

STATEMENT OF RICHARD THOMPSON, PRESIDENT, THOMPSON PUBLISHING GROUP, ACCOMPANIED BY ALLAN T. JOSEPH, COUNSEL

Mr. THOMPSON. Thank you.

Madam Chairwoman and members of the Ways and Means Committee, we sincerely appreciate the opportunity to appear before you today to explain the unfair burden that TEFRA imposes on small publishers.

I would especially like to personally thank Chairman Dan Rostenkowski for making this appearance possible. With me today are Mr. Jerry Huss, publisher of CPA Digest; Mr. Tod Sedgwick, publisher of Pasha Publications, and the representative of the Newsletter Association; and Mr. Allan Joseph, counsel for the Thompson Publishing Group.

As you know, last year, the Senate Finance Committee, in an apparent attempt to curb tax shelters, included in TEFRA a provision which makes circulation expenses a tax preference item for unincorporated publishers.

This provision adversely—and I believe unfairly—affects small publishers such as ourselves. Apparently, we have been caught up in a rather broad sweep of potential tax abuses. In this case, the sweep went too far and is causing small publishers great harm.

For publishers like myself, "circulation expenses" are the marketing dollars our company spends to solicit new subscribers. Such costs can range from 20 to 40 percent of a publisher's total expenditures.

Marketing dollars represent basic business expenditures such as salaries, rent, equipment, printing and postage. For existing publishers, circulation expenses are not a tax shelter, but a real dollar expense essential to maintaining or increasing their subscriber base.

Making circulation expenses a tax preference item in effect imposes a 20-percent tax on circulation expenses after the allowable exemption and the 10-percent amortizable amount.

Remember, TEFRA is a tax on real operating expenses of a business, not a tax on its "paper losses" like depreciation or depletion. It could conceivably impose a tax on a publisher who has no net income or one who suffers substantial losses in his publishing business.

Those hit by this tax are unincorporated publishers, the small business people that congressional policy otherwise encourages.

The TEFRA provision does allow the small business person an alternative to deducting circulation expenses as a tax preference item. The small business person may capitalize and amortize circulation expenses over a 10-year period and thus avoid making them a tax preference item.

But this 10-year period has no basis in reality. Most of our subscriptions are for 1 year, and each year we incur continuing circulation expenses to encourage existing subscribers to renew.

Besides, many subscribers only renew for 2 or 3 years before dropping the subscription. This again requires us to spend substantial circulation dollars to replace that subscriber long before the 10-

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year amortization period for the initial subscriber has run its course.

Are small publishers unfairly using circulation expenses as tax shelters? Our counsel has researched the legislative history of TEFRA and cannot find presented evidence that circulation expenses constitute a tax shelter abuse.

If such a problem exists, we would like to know of it and assist the Congress in structuring a provision to eliminate the abuse, without adversely affecting a substantial viable, operating segment of the publishing industry, namely, the small publisher.

Circulation expenses then are a publisher's marketing cost, a vital cost, if a publisher's business is to survive. TEFRA has imposed a tax on the advertising expenses of unincorporated publishers. Moreover, why are circulation expenses a tax preference item any more than editorial or printing expenditures?

Let me explain again, this TEFRA provision is most inequitable. It applies only to unincorporated publishers, which are usually the smaller businesses. The larger publishers, which are incorporated, are not subject to this tax.

It thus clearly puts us small businesses in an unfair competitive position with the giants of the industry, both from a tax and administrative compliance standpoint. The legislative history of this provision in TEFRA and comments by my counsel about it are appended to my testimony.

In conclusion, in light of the fact that no public evidence exists that circulation expenses constitute a tax abuse and because circulation expenses are essential to a small publisher's business, we recommend that circulation expenditures be deleted as a tax preference item.

Mr. Jerry Huss will now present details on the tax consequences of this provision upon a small publisher.

[The comments referred to follow:]

CIRCULATION EXPENDITURES UNDER TEFRA (PUBLIC LAW 97-248)

(A) LEGISLATIVE HISTORY

(1) On July 12, 1982 the Senate Finance Committee reported HR 4961 as a complete substitute to the original House bill.

Section 201(b)(1)(B) of the bill dealing with items of tax preference (Sections 57(a)(5) and (6) of the I.R.C.) added four perference items, mining exploration and development expenditures, circulation expenditures and research and development expenditures. These four items were treated in the same way, namely, by stating that certain expenditures will be treated as perference items to the extent that the taxpayer's allowable expenses are in excess of the amount which would have been allowable if the expenditure was capitalized and amortized on a straight line basis over 120 months.

The Senate Finance Committee Report stated that the reason for the change was that no taxpayer with substantial economic income should be able to avoid all tax liability by using tax deductions, credits, etc.

(2) On July 21 the Bill was debated on the Senate floor and passed by the Senate on July 22 by a vote of 50 to 47. No revisions to the Senate Finance Committee version of tax preferences were made at this time.

(3) On August 17 the House-Senate Conference Committee changed Section 201(b)(1)(B) of the Bill by replacing the 120 month, straight line concept to ". . . amortized ratably over the 10 year period. . ."

(4) September 3, 1982 the Bill was approved as Public Law 97-248.

(B) COMMENTS ON LEGISLATION

(1) No Public evidence that circulation expenses cause tax abuse problem in the publishing industry.

(2) Law as drafted is too broad, effecting not only tax shelters, but legitimate small publishing concerns operating as proprietorships, partnerships and perhaps Subchapter S corporations although the law is vague on this point. This was not the purpose of the law.

(3) No rationale for 10 year amortization procision in publishing industry. The 10 year provision was applied to four different types of expenses on an arbitrary basis. In the publishing industry the average useful life of a small publications subscription varies. It could be a one year period, two or three years are common, but ten years are very rare. Ten year amortization will create a substantial economic hardship for these small publishers.

(4) No exception made for publications that cease to exist. An immediate write off of any capitalized amount would create a tax preference under the law as drafted.

(5) No distinction made between normal circulation expenses and those chargeable to capital, such as start up costs for a new publication as provided in Section 173 of the Code.

(6) By making circulation expenditures as preference items the law is placing a heavy administrative burden on small businesses to determine what is or is not a circulation expense (i.e., Does the businessman have to allocate part of his annual salary, rent, utilities, bookkeeping, typist, computer expenses to circulation expense?) Failure to meet this burden would result on audit in the imposition of the alternative minimum tax together with related interest and possible penalities.

Mr. GIBBONS [presiding]. Mr. Huss, go right ahead.

STATEMENT OF JERRY S. HUSS, PUBLISHER, CPA DIGEST, MILWAUKEE, WIS.

Mr. HUSS. Mr. Chairman and members of the committee, I appreciate this opportunity to talk to you about an issue that is crucial to the survival of my business.

My name is Jerry Huss. I live in Milwaukee, Wis., where I own a small publishing company. I am submitting written testimony to you today, so I will take only a few moments to summarize its contents.

Mr. GIBBONS. Yes, sir, go ahead.

Mr. HUSS. The past 9 months have been a real nightmare for me as I have struggled to save my small publishing business from a little-noticed provision of the Tax Equity and Fiscal Responsbility Act, called TEFRA.

This provision severely penalizes me when I spend money on marketing. And, in the publishing business, marketing, continuous marketing, is the key not only to growth but to survival.

Before getting into specific TEFRA provisions, let me give you some brief information about my business.

In 1980, I started a company to publish newsletters that we sell to CPA's throughout the United States. Our legal organization is a proprietorship. We began a second newsletter in 1981 and a third newsletter in 1982.

As an entrepreneur, I am proud of our growth. In 1980, our business was strictly a one-man operation. Today, we have six full-time employees and five part-time employees and we are continuing our growth.

And we already provide almost $250,000 of business per year to Wisconsin's ailing printing industry. In addition, we spend over $100,000 per year at the U.S. Post Office.

We managed our business frugally during its first 3 years, and were able to accumulate the financial resources, personnel and credit rating necessary to grow. Our plan called for continued growth by starting a fourth newsletter in 1983. Then came TEFRA.

The problem is in section 201(b)(1)(B) of TEFRA, which includes "circulation expense" as a tax preference. This section of TEFRA could be an effort to crack down on tax abuses. I really don't know.

I draw this conclusion only because TEFRA defines "circulation expenses" as a tax preference, and the purpose of tax preferences is to curb tax abuse. In all of my contacts with publishers, I have not seen any instance where a sole proprietor uses circulation expense to abuse the Tax Code. Rather, circulation expense is essential to the survival of every publisher.

The effect of TEFRA on unincorporated publishers could be catastrophic. For a publisher, circulation expense includes printing of promotional materials, purchase of mailing labels, and postage. Circulation expense is essential to our business, and is absolutely the only means by which we obtain additional subscribers.

This is an important distinction from many tax preferences that are merely "paper deductions," such as depletion and accelerated depreciation.

In the written testimony, I have given an example of an unincorporated publisher with a $30,000 income. Without going into all the details, I'll summarize the example. If this publisher were married and had two children with itemized deductions of $6,000 under the old laws, he would have paid a $3,000 tax.

Under the new TEFRA provision, this publisher pays a $23,000 tax on only $30,000 of income. This will allow him only $7,000 a year to support his family, obviously an impossible situation.

Here is an even more drastic example, my own case: For my business, TEFRA provides a tax exceeding $45,000 this year, even though the business still shows a loss. In the publishing business, I think most people know that it takes a few years to reach the break-even point.

We are just about there.

Thus, under new TEFRA section 201, many small publishers are faced with only two alternatives: Discontinue operations or sell out to a corporate publisher.

I am sure that after giving careful thought to this testimony, you will see what the solutions are. Your immediate action is essential to prevent the devastation of many small publishers. In conclusion, let me suggest two corrective measures.

First, eliminate retroactively the portion of TEFRA section 201(b)(1)(B) that defines circulation expense as a tax preference. Your eliminating that definition is the only hope of survival of many small publishers.

Immediate correction is necessary because this unwieldy tax provision is effective right now. Here's a real example: Every time I send out direct mail advertising that costs $10,000, my Federal income tax liability increases by $2,000. But if I discontinue this "circulation expense," my subscribers will dwindle through normal attrition and my business will die.

There is a second part of this sclution you can act on. Allow publishers who have incorporated solely as a result of TEFRA the

option of liquidating. They should be taxed as if their corporations never existed.

There is precedence for this in section 305(d) of the Technical Corrections Act of 1982, which added section 6(f) to the subchapter S Revision Act of 1982. Certain subchapter S corporations were permitted to liquidate without adverse tax effects to the owners.

In closing, let me say no other business is taxed on its advertising expenditures. Is it the intent of Congress to penalize entrepreneurs who aren't incorporated, while allowing corporate publishers to escape this tax treatment? If not, I urge you to eliminate this inequitable penalty on small business.

Thank you for giving me the opportunity to appear before you today.

[The prepared statement follows:]

STATEMENT OF JERRY S. HUSS, PUBLISHER, CPA DIGEST

A NIGHTMARE

The past nine months have been a nightmare for me as I've struggled to find a way to save my small publishing business from a little-noticed provision of the Tax Equity and Fiscal Responsibility Act (TEFRA). This provision severely penalizes me when I spend money on marketing. And, in the publishing business, marketing—continuous marketing—is the key not only to growth but to survival.

BACKGROUND

Before getting into specific TEFRA provisions, let me give you some brief information about my business.

In 1980, I started a company to publish newsletters that we sell to CPAs throughout the United States. Our legal organization is a proprietorship. We began a second newsletter in 1981 and a third newsletter in 1982. As an entrepreneur, I am proud of our growth. We presently have six full-time and five part-time employees. And we already provide almost a quarter of a million dollars of business per year to Wisconsin's ailing printing industry. In addition, we spend over $100,000 per year at the U.S. Post Office.

We managed our business frugally during its first three years and were able to accumulate the financial resources, personnel, and credit rating necessary to grow. Our plan called for continued growth by starting a fourth newsletter in 1983. Then came TEFRA.

THE PROBLEM

Section 201(b)(1)(B) of TEFRA includes "circulation expense" as a tax preference. I haven't been able to determine the reason for this inclusion even after many telephone calls and letters to my Congressman and to IRS. This section of TEFRA could be an effort to crack down on tax abuses. I draw this conclusion only because TEFRA defines "circulation expense" as a tax preference, and the purpose of tax preferences is to curb tax abuse. In all of my dealings with publishers, I have not seen any instance where a sole proprieter uses circulation expense to abuse the tax code. Rather, circulation expense is essential to the survival of every publisher.

The effect of TEFRA on unincorporated publishers could be catastrophic. For a publisher, "circulation expense" includes printing of promotional materials, purchase of mailing labels, and postage. Circulation expense is essential to our business—the only means by which we obtain additional subscribers. (This is an important distinction from many tax preferences that are merely "paper deductions," such as depletion and acceleration depreciation.) Typically, circulation expense is the largest expense for a newsletter publisher.

To illustrate the problem, let's assume that an unincorporated newsletter publisher has the following income statement:

Sales	$400,000
Expenses:	
Circulation	150,000

Editorial	120,000
Administration	100,000
Total expenses	370,000
Net income	$30,000

If we further assume that the publisher is married, has two children and itemized deductions of 6,000, his tax situation is as follows:

Old tax law (1982 and before):	
Federal income tax	$3,000
Income after Federal tax	27,000
TEFRA (1983 and after):	
Federal income tax ($20,000 more than under old law)	[1]23,000
Income after Federal tax	7,000

[1] Would be even more if taxpayer has tax preferences other than circulation expense or has certain types of itemized deductions.

Obviously, this publisher could no longer support even his family on the income remaining after paying Federal income tax.

An even more drastic example: For my business, TEFRA provides a tax exceeding $45,000 this year even though the business still shows a LOSS!

At first glance, it might appear that a publisher could solve this problem simply by incorporating, since TEFRA does not include circulation expense as a tax preference for corporations. However, incorporation is not a simple solution. This is because publishers typically have a large "deferred subscription liability," that is, an obligation to provide all issues due for the remaining term of each subscription. Under Section 351 of the Internal Revenue Code, this entire liability would be taxed to the publisher as ordinary income on the date of incorporation. This additional tax liability could easily exceed $100,000 even for a small publisher.

Thus, under new TEFRA Section 201, many small publishers are faced with only two alternatives: discontinue operations or sell out to a corporate publisher.

I'm sure that after giving careful thought to this testimony, you will see what the solutions are. Your immediate action is essential to prevent the devastation of many small publishers. In conclusion, let me suggest two corrective measures.

THE SOLUTION

First, eliminate retroactively the portion of TEFRA Section 201(b)(1)(B) that defines circulation expense as a tax preference. Your eliminating that definition is the only hope of survival for many small publishers. Immediate correction is necessary because this unwieldy tax provision is effective right now. Example: Every time I send out direct mail advertising that costs $10,000, my Federal income tax liability increases by $2,000. But if I discontinue this "circulation expense," my subscribers will dwindle through normal attrition and my business will die.

There is a second part of this solution you can act on. Allow publishers who have incorporated solely as a result of TEFRA the option of liquidating. They should be taxed as if their corporations never existed. (There is precedence for this in Section 305(d) of the Technical Corrections Act of 1982, which added Section 6(f) to the subchapter S Revision Act of 1982. Certain subchapter S corporations were permitted to liquidate without adverse tax effects to the owners.)

No other business is taxed on its advertising expenditures. Is it the intent of Congress to penalize entrepreneurs who aren't incorporated, while allowing corporate publishers to escape this tax treatment? If not, I urge you to eliminate this inequitable penalty on small business.

Mr. GIBBONS. Mr. Sedgwick.

STATEMENT OF TOD SEDGWICK, PUBLISHER, PASHA PUBLICATIONS, REPRESENTING THE NEWSLETTER ASSOCIATION

Mr. SEDGWICK. Yes, Mr. Chairman, I want to abbreviate my remarks in the interest of time.

Mr. GIBBONS. Your statement will appear in the record.

Mr. SEDGWICK. My name is Tod Sedgwick. I am publisher of Pasha Publications, a newsletter publishing firm in Arlington, Va. I serve on the board of directors of the Newsletter Association, and

am grateful to the committee to have this opportunity to speak to you on the association's behalf.

The Newsletter Association is the international nonprofit trade association representing the interests of publishers of newsletters and specialized information services.

The 800 members of the association currently publish some 2,000 newsletters covering almost every conceivable business and consumer subject area.

We believe we can fairly demonstrate that the treatment of our expenses as a tax preference item is illogical, unjust, and unfairly punishes small publishing concerns in the critical early stages of their growth.

We find it illogical to tax newsletters on their selling expenses. More than 95 percent of all newsletter subscriptions are sold by direct mail advertising, which are treated as circulation expenses by TEFRA.

No other business, to the best of our knowledge, is taxed on their selling expenses. We applaud efforts by this committee to raise revenues by closing tax loopholes and stopping abuses, but this measure, as it applies to newsletter publishers penalizes not sophisticated investors, but small businessmen who are risking their own capital in an already-high-risk enterprise.

Newsletter publishing is a very high-risk business. The Newsletter Association estimates that about 50 percent of all newsletters launched fail usually within the first year. The newsletter industry is mainly a cottage industry made up of individuals with expertise in the particular area who might start their newsletters in their kitchen or garage.

For this type of newsletter publisher, without the expertise and capital of an established firm to support them, the casualty ratio is much higher than 50 percent.

For a new newsletter venture, promotion or circulation expenses are usually the largest single cost. Commonly, publishers need to spend more than 100 percent of the first year's revenue to acquire a subscription.

They do this in the hope of delivering a quality editorial product that will result in satisfactory renewal rates and profits in later years. Taxing entrepreneurs on their promotion expense just as they are attempting to launch their newsletter will make an already-difficult business that much more difficult.

We submit that TEFRA's application will have an unintended chilling effect on the establishment of news specialized publishing businesses and restrict the flow of information in the United States.

However, our largest objection to the TEFRA provision is that it is inequitable. It applies only to unincorporated newsletter publishers, the very largest well-established firms in publishing newsletters and other periodicals are not affected.

Finally, we contend that this provision defeats its own purpose of raising revenues. The provision will stifle fledgling newsletter enterprises at the early stages of their growth through taxing them on their promotion expenses.

As a result, they will be unable to grow to the point where they can employ more people, pay taxes on their profits, and stimulate

the economy. Accordingly, the Newsletter Association strongly urges this committee to repeal the provision of TEFRA that treats circulation expenses as a tax preference item.

I wish to thank the committee again for providing us with the opportunity of presenting our views on a matter which vitally affects the small businessmen who comprise the membership of the Newsletter Association.

We will be happy to answer any questions.

[The prepared statement follows:]

STATEMENT OF THE NEWSLETTER ASSOCIATION

My name is Tod Sedgwick. I am publisher of Pasha Publications, a newsletter publishing firm in Arlington, Va. I serve on the board of directors of the Newsletter Association and am grateful to the committee to have this opportunity to speak to you on the association's behalf.

The Newsletter Association is the international non-profit trade association representing the interests of publishers of newsletters and specialized information services. The 800 members of the association currently publish some 2,000 newsletters covering almost every conceivable business and consumer subject area.

The Newsletter Association would like to draw the attention of the committee to an inequity in the tax code created by the enactment of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) in its treatment of unincorporated newsletter publishers.

TEFRA amends Section 57(a) of the Internal Revenue Code of 1954 to treat "circulation expenditures" of unincorporated publishers as a tax preference item and subjects these expenditures to an alternative minimum tax of 20 percent. The Newsletter Association recognizes that the purpose of TEFRA was to raise additional revenues for the federal government and quite readily concedes that no individual or group likes to pay additional taxes.

However, we believe we can fairly demonstrate that the treatment of circulation expenses of unincorporated publishers as a tax preference item is illogical, unjust and unfairly punishes small publishing concerns in the critical early stages of their growth.

First, we find it illogical to tax newsletters on their selling expenses. More than 95 percent of all newsletter subscriptions are sold by direct mail advertising, treated as circulation expenses by TEFRA. No other business, to the best of our knowledge, is taxed on their selling expenses.

Second, the TEFRA, provision springs from an inadequate understanding of the economics of newsletter publishing.

Under TEFRA, unincorporated publishers are given two options: (1) continue to treat circulation expenditures as a current-year expense, as at present, and pay the tax preference minimum tax as applicable, or (2) capitalize the expense and amortize it over a life of 10 years.

We presume this period was selected to reflect the useful life of subscriptions gained through direct mail promotion. But this presumes an overall renewal rate of about 90 percent, which is extremely rare in the publishing business. The newsletter industry's experience is that newly created newsletters have a first-year renewal rate of about 50 percent, while newsletters that are one or more years old average a 70 percent renewal rate. This means that the useful life of a new subscription is two to three years, instead of the 10 years stipulated by TEFRA.

We applaud efforts by this committee to raise revenues by closing tax loopholes and stopping abuses. But this measure, as it applies to newsletter publishers, penalizes not sophisticated investors but small businessmen who are risking their own capital on an already high-risk enterprise.

Newsletter publishing is a high-risk business. The Newsletter Association estimates that about 50 percent of all newsletters launched fail, usually within the first year.

The newsletter industry is mainly a cottage industry, made up of individuals with expertise in a particular area, who start their newsletter in their kitchen or garage. For this type of newsletter publisher, without the expertise and capital of an established firm to support them, the casualty ratio is higher than 50 percent.

For a new newsletter venture, promotion or circulation expenses are usually the largest single cost. Commonly, publishers need to spend more than 100 percent of the first year's revenue to acquire a subscription. They do this in hope of delivering

a quality editorial product that will result in satisfactory renewal rates and profits in later years.

Taxing entrepreneurs on their promotion expense just as they are attempting to launch their newsletter will make an already difficult business that much more treacherous. We submit that TEFRA's application will have an unintended chilling effect on the establishment of new specialized publishing businesses and restrict the flow of information in the United States.

However, our largest objection to the TEFRA provision is that it is inequitable. It applies only to unincorporated newsletter publishers. The very largest, well established firms in publishing newsletters and other periodicals are not affected. Why should an unincorporated publisher, normally small and much newer in the business, be subject to a tax which the corporate giants are not?

Initially, it would appear that unincorporated publishers could solve this dilemma by incorporating, but this is not as simple a solution as it appears. We suggest that one of the stated purposes of revising the tax code in recent years has been to eliminate corporations set up solely for tax purposes. The TEFRA provision as it relates to circulation expenses will create a number of such corporations in the newsletter business. Moreover, publishers who have been operating as a sole proprietorship or partnership will find, if they investigate incorporation, that the amounts of deferred subscription income which they have on their books is subject, under Section 351 of the Internal Revenue Code, to taxation as ordinary income on the date of incorporation, leaving them, quite possibly, with no alternative but to sell the business.

Finally, we contend that this provision defeats its own purpose of raising revenues. The provision will stifle fledgling newsletter enterprises at the early stages of their growth through taxing their promotion expenses. As a result, they will be unable to grow to the point where they can employ more people, pay taxes on their profits and stimulate the economy.

Accordingly, the Newsletter Association strongly urges the repeal of the provision in TEFRA that treats circulation expenses as a tax preference item.

I wish to thank the committee again for providing me the opportunity of presenting the views of the Newsletter Association on a matter which vitally affects the small businessmen who comprise its membership.

Mr. GIBBONS. Does Mr. Joseph have a statement?

Mr. JOSEPH. No additional comments.

Mr. GIBBONS. First of all, I am very happy that you brought this to our attention, and so is Chairman Rostenkowski, and we are asking the committee staff to take a close look at this and see what can be done to remedy the situation.

I paid very close attention to TEFRA last year, but I do not recall the distinction surrounding this, and that is the reason for the question.

Are there any sheltering games going on in publication expenses that you all are aware of?

Mr. HUSS. I am aware of three limited partnerships that are set up as a newsletter business. They must be the source of the new TEFRA provisions, but this is only a guess, and I have been making phone calls to Washington for 9 months to try to find out. Honestly, I don't know.

I am only guessing that someone saw one of these limited partnership prospectuses and said: "Here is something I have got to stop." I am not familiar with these partnerships, and I don't know if they are good or bad. But I think the unintended result of the way the legislation is drafted is that it affects all of us whose full-time business is publishing without operating in corporate form.

If I had incorporated in 1980, there would be absolutely no tax problem when I started the business. Somehow, in the wording, TEFRA has taken all unincorporated businesses and put them in the same category as the limited partnerships.

Certainly, one possibility would be to change the legislation so it still applies to limited partnerships but does not apply to an individual proprietor working in his own business full time.

Mr. GIBBONS. Mr. Joseph.

Mr. JOSEPH. Sir, our law firm has monitored the tax shelters that have come through our partnership in the past years, and I have none dealing with circulation expenses.

Mr. SEDGWICK. On the board of the Newsletter Association, we have 800 members, and before this morning, I was familiar with one syndication and Jerry Huss told me this morning about two other ones.

Compared to the entire industry, it is a minuscule component of the industry. We are also concerned, as you are, that there was no discussion about this provision last year before the TEFRA was enacted.

Mr. GIBBONS. Well, I understand from talking to people, it came from some genius over in the Senate. I wonder if you all had any chance to talk to them over there?

Mr. THOMPSON. If we could find him, we would love to talk to him.

Mr. GIBBONS. I am not sure I can find out where it came from, but we will take a good, hard, conscientious look at it to try to relieve you. These circulation expenses are as you described them. They are what, again, repeat for the record?

Mr. SEDGWICK. The Treasury defined circulation expenses as any expenses which are incurred in connection with gaining new subscriptions and for, in the newsletter industry, pretty much the only way you can gain new subscriptions is through direct-mail promotion and circulation of those promotion expenses.

Mr. GIBBONS. So, would you have postage, and printing, and mailing lists, and things of that sort?

Mr. SEDGWICK. That is right, direct-mail promotion to large numbers of people and this constitutes 20 to 40 percent of the budget of an average newsletter company.

Mr. GIBBONS. Is it a matter of timing of the expenses versus the timing of the revenue? You say get a 3-year subscription. How do you normally write? Do you get all the income the first year or include it in income for 3 years?

Is it a matter of timing? I don't understand what that genius in the Senate was driving at.

Mr. HUSS. I think for a brandnew publisher, for example, in 1980, when I started my business, yes, I deducted all the expenses in 1980. I was able to defer some of the income to 1981, because that is when the subscriptions applied to.

If there had been a law in effect at that time that said, OK, for a brandnew publisher you cannot deduct all of your expenses this year, you have to prorate them over 2 or 3 years, not the 10 years that is provided in this bill, but over 2 or 3 years, which is typically the average life of a subscription, that would have been fair at that time.

Obviously, now that I am into the game, if someone were to come to me today and say, OK, this year you can only deduct one-third of your expenses, that also would be catastrophic.

If it is going to be changed, it should apply to a publisher as of the first day he goes into business. I think that would be fair.

Mr. GIBBONS. About mailing lists, you deduct all the expenses connected with the mailing list in the first year, or do you spread them out? What does IRS let you do on a mailing list as far as keeping it up?

Mr. HUSS. In our case, we purchase all mailing lists. For example, we sell our letters to CPA's so we will buy the membership list of the American Institute of CPA's. It is not an in-house list. We lay out cash.

If they send us a mailing list within 2 weeks, we have to send them a check for that. And at that time, we deduct the cost of the mailing list.

Mr. GIBBONS. How many years can you use that mailing list after you get it?

Mr. HUSS. Only once. It is a one-time purchase. If I want to use it next month, I have to pay for it again. I am only deducting my actual cash outlay for that specific mailing.

Mr. GIBBONS. I am just trying to find out where that genius found this.

Mr. HUSS. I have been looking for 9 months. I have called all kinds of people. No one can tell me the origination of this, and certainly no one can tell me how someone arrived at a 10-year amortization for subscription expenses.

Mr. SEDGWICK. Theoretically, you could incur large promotional expenses in the first year, and then defer some of the income to the second year. So, in the early stage, you could generate losses, but this averages out when your circulation levels out, then that income that you defer does come back, and you have to recognize it at that time, and then you can get into the opposite situation where if you become a mature newsletter and then the recession hits and your circulation declines, then you are actually recognizing more income than you receive in cash.

So, while you may get some tax benefit in the early years, you always run the risk of having it come back to haunt you in later years.

Mr. GIBBONS. Thank you very much.

Mr. JOSEPH. Historically, a distinction was made between start-up, circulation expenses and normal circulation expenses, and under the section 173, they did not allow the capitalization of normal circulation expenses.

Yet, in the TEFRA, they make no distinction at all. All circulation expenses are lumped together, and there is no specific definition of circulation expenses.

Theoretically, it can include a portion of the President's salary, part of the rent for the premises. There are no guidelines, and TEFRA has created a real trap, because if you don't calculate your circulation expenses correctly, then you might improperly report your taxes.

You could have interest and penalties imposed upon you, and there are no real guidelines.

Mr. GIBBONS. But you can avoid that if you incorporate, say, a subchapter S?

Mr. JOSEPH. I am not sure. There is a difference of opinion. My personal opinion is that a subchapter S corporation would be subject to the preference provisions, but there is a difference of opinion there.

Mr. SEDGWICK. And there is a serious problem. Many of us would like to incorporate. There is a serious problem there because upon incorporation, you have to pay an immediate ordinary income tax on all the deferred income, which is too catastrophic for most of us.

Mr. HUSS. I just had a tax attorney and the CPA both independently research that question for our newsletter operation. If I took my sole proprietor balance sheet as it is today and put it in a corporation, I would immediately incur a tax liability of a little over $150,000.

Mr. GIBBONS. I understand. I got your problem. Thank you very much. We appreciate your coming.

Mr. THOMPSON. Thank you, Mr. Chairman.

Mr. SEDGWICK. Thank you very much for your interest.

Mr. GIBBONS. We will have a panel involving the American Hospital Association, Mr. Jack Owen, the Ohio Hospital Association, Mr. William Weimer.

STATEMENT OF JACK W. OWEN, EXECUTIVE VICE PRESIDENT, AMERICAN HOSPITAL ASSOCIATION

Mr. OWEN. Mr. Chairman, I am Jack Owen, executive vice president of the American Hospital Association and director of its Washington office.

I appreciate the opportunity to appear before you today. We have submitted written testimony, which I request to become part of the committee record, and I would like to make some comments on it.

Mr. GIBBONS. Both your statements will be included in the record. You may proceed as you wish.

Mr. OWEN. The Social Security Act Amendments of 1983 included some landmark legislation which established a prospective payment system, based on diagnostically related groups. I think it is fair and safe to say that the American Hospital Association had a special partnership with this committee and other committees of Congress in developing this prospective payment system, and we recognized that there would be some controversial issues which would arise over the next few years as the system develops.

We hope to continue working with the committee in refining and improving the system, and we look at this committee hearing as part of that effort.

I would like to discuss two or three things that we are concerned about in this technical corrections bill, H.R. 3805, which can be of some help.

First, the issues regarding peer review organizations. Second, the problem of acceleration and transition to a national prospective pricing system. Third, the problem we have with the medicare-case-mix index. Then, I would like to comment very briefly on a problem dealing with tax-sheltered annuities.

First, Public Law 98-21 prohibits hospitals or hospital associations from becoming peer review organizations or controlling peer review organizations.

We agree with that. We don't think that a hospital association or hospitals should control the peer review organization. However, under current law, hospital representatives serve on governing boards in many States.

Both in your State, Congressman Gibbons, and yours, Congressman Duncan, there are hospital people who serve on these boards.

Under the present technical corrections bill, what you would do is exclude from any peer review involvement community leaders who represent consumers, major employers, unions or insurers who also serve on hospital boards, and it also prohibits from serving on these boards hospital-based physicians, and we think that that is a mistake, because a lot of the ability and information and direction that are needed in peer review organizations can come from these people, and we think that should be corrected.

The second area that we are concerned about has to do with the blending of the Federal rate in the prospective payment schedule. Section 441 of H.R. 3805 includes a provision that would accelerate transition to a national prospective pricing system for hospitals with cost reporting years beginning on dates other than October 1.

About two-thirds of the hospitals in this country have other than October 1 fiscal years, so that about two-thirds would be affected by this.

We believe this undercuts the purposes of the transition period, which is to provide time for hospitals to accommodate, make management decisions on the national average price of treating a medicare patient. It would provide an opportunity for Congress and HHS to assess the desirability of moving to a national pricing system.

Public Law 98-21 was intended to ease the transition caused by movement toward these national pricing systems, and H.R. 3805 would shorten the transition period, thereby undercutting the committee's original intention.

The way you would do this is by using the October 1 fiscal year for those hospitals coming into the system either January 1 or July 1 of their own fiscal year. They would be brought into a national rate as the transition takes place, and would be unable to know what that raise would be, to be able to budget a year in advance.

So we think that that provision in H.R. 3805 ought to be corrected.

Also, in our testimony is a concern that we have with the outliers which are in this program. On page 18 of my written testimony, I point that out that the outliers system—the way it is defined—causes problems. The outliers, just for a quick definition, are those patients that fall out of the DRG classification.

When they fall out, they are usually patients who require some additional treatment than what normally would be considered standard for a particular diagnosis.

They usually go to tertiary centers or some of the big medical centers. The way the system is designed and the way the Department of Health and Human Services would implement it, would remove about 5.7 percent from all of the hospitals' actual base price and then that 5.7 will be added to the outliers.

We would think that it would be a lot fairer if the outlier portion was only applied to the Federal complement of the rate, and we hope that the committee will take that into consideration.

Now, third, we are quite concerned about the appeals under prospective payment as they relate to case mix. The calculation of the medicare case mix index offers no avenue of appeal, and hospital base year costs will be adjusted in 1981 even though errors can occur in making judgments.

We believe that a hospital should be allowed to appeal its 1981 case mix by providing complete 1981 or 1982 case mix data, so that a hospital going into the program that has not had an opportunity to review its medical record and finds that the case mix is different than what the HHS has looked at it on the basis of an average could be able to come in and say, "Our case mix is different, here is the evidence, and we would like to make that change."

The last thing that I would like to comment on briefly has to do with the tax-sheltered annuity, and that you will find on page 5 of my testimony. Basically, we have no quarrel with the act as far as including the tax-sheltered annuity and the FICA tax.

What we are concerned about is retroactivity. If the original law said that it would be effective January 1, 1984, we think you ought to stick with that law, because that is what our hospitals have geared up to do.

Reverting now, going back to March 1983, creates a problem for many of our hospitals that do provide tax-sheltered annuities.

In conclusion, I would like to say that I appreciate the opportunity of appearing here today, and I hope that we can continue to work with the committee in approving and refining the prospective payment system, and there will be lots of refinements needed as we go down the track on this, I hope that our views on H.R. 3805 and related issues will be helpful to the committee in looking at what will provide the best way to get this prospective payment system going.

We are not fighting with the prospective payment system. We think it is a move in the right direction, but there need to be some refinements. We have a concern that the citizens in this country get the kind of quality medical care gotten in the past, and will continue to get in the future.

Thank you, Mr. Chairman.

Mr. GIBBONS. Thank you, Mr. Owen.

[The prepared statement follows:]

STATEMENT OF THE AMERICAN HOSPITAL ASSOCIATION

SUMMARY

The Social Amendments of 1983 (P.L. 98-21) included landmark legislation, which the American Hospital Associaiton (AHA) worked closely with this Committee and Congress to enact, requiring Medicare payment rates for hospital services to be established on a prospective basis, using a patient case classification system based on diagnosis-related groups (DRGs).

The AHA believes that it established a special partnership with Congress in developing prospective pricing, which is an important step in system reform. While controversial issues that must be addressed will arise over the next few years as the system develops, the AHA hopes to continue working with Congress in refining and improving the system. H.R. 3805, the Technical Corrections Act of 1983, contains

several provisions of concern to hospitals, ranging from tax-deferred annuities, to peer review organzations (PROs), to prospective pricing.

This legislation contains a provision that would amend P.L. 98-21 by changing the January 1, 1984 effective date to March 4, 1983, for making contributions to tax-deferred annuities under salary reduction plans subject to Federal Insurance Compensation Act (FICA) taxes. This provision would preclude payments of refund claims that should be provided to employers and employees for amounts included in the FICA wage base during years 1980 to 1982. While the AHA has no objection to the provision in P.L. 98-21, the Association opposes making the provision retroactive due to the unfairness and inequity of doing so.

The bill also contains two provisions affecting utilization and quality control. One mandates that professional standards review organizations (PSROs) be considered like PROs until the latter have been implemented, while another mandates that hospitals exempt from the prospective payment system also be required to contract with PROs.

The AHA would like to take this opportunity to raise another issue in regard to the PRO program. Under P.L. 97-248, the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), Congress prohibited hospitals or hospital associations from becoming PROs or controlling PROs. While the AHA agrees with that position, the interim final regulations would prevent any person with administrative responsibility in a hospital or hospital association from even being a member of a PRO governing board. If hospital representatives are prevented from sitting on PRO boards, it will be difficult to achieve the close cooperation with providers that is necessary to accomplish the goals of this program. Therefore, the AHA recommends that an amendment be considered to permit the participation of hospital representatives in the program.

Another provision contained in thie measure would accelerate the transition to a national prospective pricing system for hospitals with cost-reporting years beginning on dates other than October 1. P.L. 98-21 provided hospitals with three-year transition period to national urban and rural DRG rates. H.R. 3805 would result in hospitals with different fiscal years operating on different blend schedules The AHA believes that this would undercut the purposes of the transition and a major advantage of the prospective payment system—predictability for hospitals. It would result in not providing an accurate projection of revenues for hospitals with cost-reporting years beginning on any date other than October 1. The AHA recommends that the blend factors remain based on the hospital cost-reporting year, which is what the Association believed was the intent of the original legislation.

In addition, the AHA is concerned that there is no opportunity to appeal either the calculation of the Medicare case mix—or contested items in the base-year cost report—even though both can involve significant errors. The AHA believes that a hospital should be permitted to appeal its 1981 case-mix index by providing complete 1981 or 1982 case-mix data.

Other issues addressed in our statement include the computation of the area wage index used in developing the prospective price schedule, methodology for determining the "outlier" adjustment, lack of special treatment for hospitals with a disproportionate share of Medicare and low-income patients, and inadequate definition of provision for national and regional referral centers.

INTRODUCTION

Mr. Chairman and members of the Committee, I am Jack W. Owen, executive vice president of the American Hospital Association and director of its Washington office. The AHA is the principal organization of this nation's hospitals, with approximately 6,300 member institutions and more than 35,000 personal members. Thank you for giving me the opportunity to testify before you today.

H.R. 3805, Technical Corrections Act of 1983, has several provisions of concern to hospitals. These include:

The setting of March 4, 1983—the day of enactment of P.L. 98-21—as the effective date for applying FICA taxes to contributions to tax-deferred employee annuities by tax-exempt organizations;

The removal of P.L. 98-21's exemption PRO involvement by hospitals exempt from the Medicare prospective payment system and treatment of PSROs during the transition from PSROs to PROs, which lead the AHA to suggest a further refinement of the PRO program;

The revision of P.L. 98-21's federal/hospital blend schedule for prospective payment; and

Corrections in appeals procedures for the prospective payment system, to which the AHA has an addition.

I will address each of these in turn, after which I will comment briefy on four other prospective payment issues—computation of the area wage index used in developing the prospective price schedule, methodology for determining the "outlier" adjustment, lack of special treatment for hospitals with disproportionate shares of Medicare and low-income patients, and inadequate definition of provision for national and regional hospital referral centers.

FICA REFUNDS ON TAX-DEFERRED ANNUITIES

H.R. 3805 contains a provision (Section 402[g]) that would amend Section 327(d) of P.L. 98-21 by changing the January 1, 1984 effective date to March 4, 1983, for including contributions to tax-deferred annuities under salary reduction plans subject to FICA taxes, and preventing refunds for amounts previously contributed. Because most tax-exempt organizations, including hospitals, have subjected such amounts to the FICA tax, the provision would effectively preclude payments of refund claims that should be provided to employers and employees for amounts erroneously included in the FICA wage base during the years 1980 through 1983.

Under Section 403(b) of the Internal Revenue Code (IRC), tax-deferred annuities may be purchased on an individual basis for employees of Section 501(c)(3) tax-exempt entities. In 1965, the Internal Revenue Service (IRS) held that amounts contributed to these annuity plans on behalf of employees were to be treated as "wages" for purposes of paying FICA and Federal Unemployment Taxes (FUTA)(Rev. Rul. 65-208). This IRS policy was implemented despite the fact that such amounts are not subject to income tax withholding.

In a 1981 decision, *Rowan Companies, Inc.* v. *United States,* the U.S. Supreme Court ruled invalid Treasury regulations requiring inclusion of employer-provided meals and lodging in wages for computation of FICA and FUTA. While FICA, FUTA, and federal income tax withholding are all computed on wages, the IRS had defined wages differently for these respective taxes. For example, meals and lodging were excluded from income tax withholding but included in FICA Taxes. The Supreme Court concluded that this discrepancy in defining wages did not reflect the intent of Congress.

Although the decision on the *Rowan* case did not specifically address the issue of Section 403(b) annuities, it did express the view that the definition of wages must be consistent for FICA, FUTA, and income tax withholding unless Congress provided a clear statutory exception. In P.L. 98-21, Congress attempted to clarify the issue in a prospective manner. Under a provision, effective January 1, 1984, wages taxable for FICA purposes are to include amounts used to purchase tax-deferred annuities through salary reduction programs.

The AHA has no objection to the provision in P.L. 98-21. However, the Association does oppose the provision in H.R. 3805 which would make it retroactive to March 4. The AHA believes such a policy is both unfair and inequitable, and urges the Committee to maintain the original position adopted in P.L. 98-21.

HOSPITAL PARTICIPATION IN PEER REVIEW ORGANIZATIONS

Need for hospital representatives on PRO governing boards

As I have already indicated, H.R. 3805 contains two provisions (in Section 411) affecting utilization and quality control: one for PSROs to be funded in the same manner as PROs until the latter have been implemented, and another for hospitals (psychiatric, rehabilitation, pediatric, and long-term care) exempt from prospective payment to contract with PROs for quality of care reviews. Because the bill has these amendments, I urge you to consider yet another, one to clarify language involving hospital participation in PRO governing boards.

The AHA, prior to August 3 of this year, opposed PSROs and sought legislation to abolish them. On August 3, the AHA House of Delegates—our policy-making body with representatives from throughout the nation—voted to support prompt implementation of the PRO program created by Conress in P.L. 97-248. The Association is working with the Department of Health and Human Services (HHS) to assure that final regulations and contract awards are issued by P.L. 98-21's deadline of October 1, 1984 for hospitals in the Medicare program to have agreements with PROs in their states or areas.

Both to achieve this goal and to fulfill an even greater one—an efficient and effective peer review program—it is essential that hospital personnel work closely with physicians and PRO contractors to assure continuation of high quality care in this period of financial constraints.

In P.L. 97-248, Congress prohibited hospitals or hospital associations from becoming PROs or from controlling PROs ("the Secretary shall not enter into a contract . . . with any entity which is, or is affiliated with [through management, ownership, or common control], a health case facility, or association of such facilities, within the area served by such entity or which would be served by such entity if it entered into a contract with the Secretary . . . ."). The AHA agrees with this provision—that a hospital or hospital association should neither form nor control a PRO. Unfortunately, in implementing the provision, the interim final regulations—issued August 15—go far beyond Congress's intent. The proposed rules would prevent any person with administrative responsibility in a hospital or hospital association from even being a member of a PRO's governing board.

Under the current PSRO program, hospital representatives serve on governing boards in a majority of states. The average PSRO that includes such representatives has one to three on boards of 15 to 21 members. In addition, physicians who are hospital-based or who serve on hospital boards seem to be significantly represented on PSRO governing bodies.

There is a fundamental difference between exercising control over the PRO and having hospital representation in peer review. The intent of the provision in question is to prevent a conflict of interest due to common control. Allowing a hospital representative to sit as one of several members on a PRO governing board does not bias the activities of the PRO. On the other hand, foreclosing hospital participation denies the PRO needed expertise and perspective. As presently drafted, the interim final regulations prohibit hospital-based physicians with administrative functions such as medical directors and department heads from sitting on PRO boards. Furthermore, this blanket prohibition against hospital governing board members would exclude from PRO involvement those community leaders representing consumers, major employers, unions, or insurers who also serve on hospital boards.

If hospital representatives are prevented from sitting on PRO boards, it will be difficult to achieve the close cooperation between hospitals and physicians that is necessary to accomplish meaningful reductions in nonessential utilization of services and assure high quality of care.

Recommended amendment language

Therefore, I urge you to add the following language to H.R.3805:

Insert at the end of Section 1153(b)(3) of P.L. 97-248—"Nothing in the foregoing sentence shall be deemed to prohibit a governing body member, officer, or managing employee of a health care facility from serving on the governing body of a peer review organization, provided that all persons having such a relationship to any health care facility comprise a minority of such governing board."

Without such an amendment, HHS may, in its final regulations, interpret the P.L. 97-248 provision so narrowly that anyone with a hospital connection, including an administrator, a trustee, or a hospital-based physician, will be unable to participate in the program.

Delegated review

The purpose of the new PRO program is to create an effective and efficient system of peer review. The AHA believes that this goal cannot be achieved if the program is to operate without delegated review, which is a system of making use of already effective hospital utilization review programs,

While the PRO law specifically states that the prohibition against hospital-PRO affiliations does not preclude hospital-PRO subcontracts, it fails to clarify the use of hospital utilization review for efficient PRO review.

An efficient peer review program would not duplicate reviews now performed within hospitals, but would complement them by making use of their findings. Medicare already requires each hospital to perform internal utilization review and the new system of prospective prices will make effective internal utilization review essential to a hospital's survival. The AHA believes that delegation would allow more effective use of PROs by enabling them to direct their efforts toward ensuring effective hospital utilization review programs rather than diffusing their energies by attempting to review each individual case. In this manner, PROs could focus their efforts on providers that have failed to demonstrate their ability to control utilization appropriately. The Association believes that the PRO program should make maximum use of subcontracting to allow hospitals which can effectively perform utilization review to do so, and concentrate the program's efforts on those hospitals which are not capable of carrying out this activity.

Recommented amendment language

Therefore, I urge you to add the following language to H.R.3805:

Insert in Section 1153(c)(1) after the words "subcontract for the performance of all or some of such functions"—subcontract, if the organization finds that the provider will effectively and efficiently review itself."

HOSPITAL FEDERAL BLEND IN THE PROSPECTIVE PAYMENT SCHEDULE

Acceleration of move toward national pricing

Section 411 also includes a provision that would accelerate the transition to a national prospective pricing system for hospitals with cost-reporting years beginning on dates other than October 1.

As you know, Congress—through a proposal made by this Committee—provided in P.L. 98-21 that each hospital would have a three-year transition to national urban and rural DRG rates, in terms of the prospective pricing schedule for Medicare hospital inpatient payment. The statute provides for a blend of hospital and federal components: in the hospital first year, 75 percent of the hospital component and 25 percent of the federal component; in the second year, 50 percent of each; and in the third year, 25 percent of the hospital, and 75 percent of the federal, component. In the fourth year, there is to be a full federal component, in the form of urban and rural rates.

The federal component itself is a blend of a national rate and a regional rate. Under P.L. 98-21, it is to be 100 percent regional the first year, 75 percent regional and 25 percent national the second year, and 50 percent regional and 50 percent national the third year. In the fourth year, it is to be 100 percent national.

P.L. 98-21 does not require HHS to change the blending of the regional and national portions of the federal component according to the federal fiscal year. However, the Department has done so in its interim final regulations on prospective payment, issued September 1, and Section 411(b)(1) of H.R. 3805 would make this mandatory. Under this procedure, the hospital with a cost reporting period which coincides with the federal fiscal year beginning October 1 would have the following blend schedule:

[In percent]

	Year—			
	1	2	3	4
Hospital component	75.0	50.0	25.0	0
Regional component	25.0	37.5	37.5	0
National component	0	12.5	37.5	100

In contrast, a hospital with a cost reporting year beginning July 1 would have the following schedule:

[In percent]

	Year—			
	1	2	3	4
Hospital component	75.0	50.0	25.0	0
Regional component	20.3	28.1	9.4	0
National component	4.7	21.9	65.6	100

In the AHA's view, this policy undercuts the purposes of the transition period, which are to provide time for hospitals to accommodate and make management decisions at a national average price of treating a Medicare patient, and to provide an opportunity for HHS and Congress to assess the desirability of moving to a national pricing system. As you may recall, this provision was intended to ease the dislocation caused by the movement toward national DRG prices. H.R. 3508 would shorten the transition period, thereby undercutting the committee's original intention. Moreover, it undermines one advantage of a prospective pricing system—predictabil-

ity—for the hospital by making an accurate projection of revenues impossible for hospitals with cost-reporting years beginning on any date other than October 1.

Recommended amendment language

The AHA recommends, therefore, that blend factors be changed according to the hospital cost reporting year, as we believed was the intent of the original legislation. Such a policy would help ensure equitable treatment of all hospitals under prospective pricing and help achieve the goals of the transition period. In line with this recommendation, the AHA offers the following language to replace that in Section 411(b)(1) of H.R. 3805:

"Section 1886(d)(1) of such Act is amended—

"(A) by striking out ", or discharges occurring" in subparagraph (c) and

"(B) by striking out ", or discharges occurring" in subparagraph (d)."

APPEALS UNDER PROSPECTIVE PAYMENT

Calculation of case mix

H.R. 3805 would make several changes in appeals procedures under prospective pricing, to which the AHA recommends an addition.

The hospital component to which I alluded earlier is based on a hospital's own costs per Medicare case in the hospital's cost-reporting year beginning between October 1, 1981, and September 30, 1982. The base-year costs used to compute the component will be determined according to an elaborate formula that takes into account exclusions (e.g., captial costs, education programs) and inclusions (e.g., Medicare malpractice expenses), as well as adjustment (e.g., Medicare case mix; outlier costs; update for hospital market basket increases, technology factors, and budget neutrality).

It is the calculation of the Medicare case mix that concerns us most, particularly because HHS—in interpreting Pub. L. 98-21—offers no avenue for appeal. A hospital's base-year costs will be adjusted by the hospital's 1981 Medicare Provider Analysis and Review (MEDPAR) case-mix index. Even though significant errors can occur in making this adjustment, due both to the 20 percent MEDPAR sample's not being representative of the hospital's Medicare case mix and to the hospital's total case mix perhaps having changed between 1981 and the prospective pricing base year, the interim final regulations preclude any appeal of the 1981 case-mix indices.

In the AHA's view, a hospital should be allowed to appeal its 1981 case-mix index by providing complete 1981 or 1982 case-mix data. Such appeal would help insure that the hospital component would more accurately reflect the costs of treating the mix of patients admitted to the hospital in the base period.

Disallowance of base-year costs

Moreover, when a hospital successfully appeals a disallowance of costs in its base period, the interim final regulations would allow only a prospective adjustment of the hospital-specific component. However, the AHA believes that hospitals successfully appealing base-period costs should have their hospital-specific components adjusted retroactively and prospectively. This would prevent the timing of the appeal decision from affecting the amount of payment received.

ADDITIONAL COMMENTS: AREA WAGE INDEX, "OUTLIER" ADJUSTMENT, DISPROPORTIONATE SHARE OF MEDICARE AND LOW-INCOME PATIENTS, AND NATIONAL AND REGIONAL REFERRAL HOSPITALS

Having addressed prospective payment issues that relate to the blend schedule and allowance for appeal, I would like to bring to your attention four other topics that concern the hospital field. Although the AHA will submit recommendations to HHS on these—as well as other—issues in the proposed prospective pricing regulations, I would like to alert you to difficulties that may be the subjects of letters to individual members from their constituent hospitals and that might be considered in the process of reviewing possible amendments to H.R. 3805.

Computation of the area-wage index

The first involves HHS' handling of area-wage indices in development of the prospective pricing schedule. In making the schedule, the Department has detemined labor and non-labor subcomponents of the federal component of the rate I discussed earlier. In so doing, it has adjusted the labor subcomponent to reflect the level of wages prevailing in a Metropolitan Statistical Area (MSA), a non-MSA, or, in some cases, the state in which a hospital is located.

Making one adjustment for all hospitals in a given MSA and another for all facilities in a given non-MSA ignores the fact that a hospital located adjacent to an urban area draws employees from the same labor market as a facility inside the area. In addition, it rejects the substantial variations in wages that occur in rural areas.

Moreover, in developing the methodology, HHS has failed to take into account the effects of regional variations in the mix of part-and full-time employees. The exclusion of the wage experience of federal hospitals also needs to be re-examined in terms of potential inequities.

AHA believes that a fair way to address this problem in the short run is to: (1) recompute the area-wage index differences in part-and full-time employment using available Medicare cost-report data; and (2) permit individual hospitals to appeal their area-wage indices or their MSA, non-MSA designations when they are able to demonstrate their unique labor market experiences.

Methodology for determining the "Outlier" adjustment

The second topic is HHS' intent to reduce the above-mentioned hospital component by 5.7 percent in order to compensate for additional payments made for "outlier" cases (those that fall far from the mean, either in length of stay or cost of treatment). Such a reduction in the hospital component is inappropriate because outlier cases will not be randomly distributed across hospitals, nor will the cost of such cases as a percentage of Medicare operating costs be uniform among all hospitals.

A fair way of making the adjustment would be to apply to the hospital component a hospital-specific outlier factor that either is based on the hospital's actual outlier experience in the base year, or based on the percentage of costs in each DRG that is associated with outlier cases. Because each alternative may be administratively infeasible, the AHA believes that during the transition period, outlier payments should be made only for the federal component of the price, weighted by the appropriate blend factor. Moreover, a hospital's base-year costs already reflect its individual outlier experience.

Disregard of hospitals with disproportionate shares of medicare, low income patients

The third is HHS' refusal to give special treatment—as prescribed by Congress in P.L. 98-21—to a hospital that admits a disproportionate share of Medicare and low-income patients. In the proposed prospective pricing regulations, HHS justifies this policy on the basis that internal studies have failed to demonstrate any significant relationship between a hospital's volume of Medicare and Medicaid patients and its average, case-mix-adjusted cost per case. However, in the preamble to the final regulation implementing the cost-per-case limits of TEFRA, HHS indicated each 10 percent increase in the ratio of Medicaid utilization above the mean explains a .6 percent increase in Medicare costs subject to the cost limit. HHS found this effect to be negligible; however, we do not. Based on these preliminary figures, we recommend that in the short term, HHS make an adjustment based on these data until such time as further analyses are completed. We also urge that the data and methodology used in performing these studies also be made available.

Provision for national and regional referral hospitals

The fourth problem is HHS' handling of an adjustment—also prescribed by Congress in P.L. 98-21—for special treatment for national and regional referral hospitals. According to the proposed regulations, a hospital would be eligible for such treatment if it met either of these two criteria: (1) it is an acute care facility operating more than 500 beds and is located outside the boundaries of an MSA; (2) it admits 60 percent of its Medicare patients from out of state or from communities more than 100 miles from its location, and 60 percent of all its Medicare services are provided to patients from out of state or from communities more than 100 miles away.

The interim final regulations provide that hospitals in the 500-bed, rural area category be paid according to the urban price schedule HHS has developed. The regulations do not address payment to hospitals in the 60-percent, 100-mile category, which seems to be an oversight by HHS.

The AHA believes that the criteria are unduly restrictive, and is working with referral center representatives to review the HHS definitions and suggest definitions of its own.

CONCLUSION

The complexity of H.R. 3805 has given the AHA an opportunity to address a variety of issues affecting hospitals, from tax-deferred annuities, to PROs, to prospective pricing. If other issues arise during markup of the bill, the AHA would be pleased to submit additional views and materials.

In a hearing last week of this Committee's Subcommittee on Health, a member referred to the "real partnership" that existed between the Committee and the hospital field in the realization of the prospective pricing system. As amendments are proposed to refine and improve that system, the AHA would like to continue the partnership. The Association views the technical corrections in H.R. 3805 as an opportunity for cooperation in this effort.

Mr. GIBBONS. Mr. Weimer?

STATEMENT OF WILLIAM WEIMER, VICE PRESIDENT, OHIO HOSPITAL ASSOCIATION

Mr. WEIMER. Thank you, Mr. Chairman.

I also submitted copies of my testimony, and would like to comment on it.

The Social Security Admendments of 1983 have created serious and we believe inadvertent problems for a certain number of Ohio hospitals, namely those that have converted from political subdivisions to nonprofit control.

The provision, which is section 102 of the Social Security Act, requires all employees of nonprofit agencies to participate in social security. The problem occurs as this section is affected by Ohio law, namely, section 145.01 of the Ohio Revised Code which defines a public employee as anyone hired by a public employer regardless of the current status of that employer.

Individuals covered by the State pension system must remain in that system, even though the hospital has changed from governmental to private control.

We have an unusual State definition of a public employee, and end up therefore with a mandatory participation for a certain number of individuals in both PERS, which is mandated at the State level, and social security mandated at the Federal level.

Approximately 1,000 employees face this double coverage and I have attached a list of those caught up in this situation.

We have discussed this problem at the State level and while the Ohio Legislature is willing to act, a solution is beyond their ability. The Ohio Hospital Association has prepared language which speaks specifically to the employees of political subdivision hospitals which have converted to nonprofit control prior to the effective data of the 1983 amendments.

Relief for subsequent conversions—from political subdivision to nonprofit status—would have to be handled at the State level. Basically, the language that we have prepared encapsulates the problem. I would like to stress the proposed language deals with a very finite population. That is those hospitals and employees that have exercised their right to convert from political subdivision to nonprofit status prior to the effective date of section 102 of the Social Security Admendments of 1983.

This group of 1,000 individuals will eventually retire or otherwise leave Ohio's public employee retirement system. There is no open door for future egress from social security.

I would stress that we are requesting relief from double coverage, not for nonprofit institutions that have opted out of social security. Our amendment would not help that group, but for a group of responsible institutions that are actively seeking to obey the law.

As I stated earlier, I don't believe that Congress contemplated this double coverage situation, and I would respectfully request your attention to our suggested solution.

[The prepared statement follows:]

STATEMENT OF WILLIAM WEIMER, VICE PRESIDENT, PERSONNEL SERVICES, OHIO HOSPITAL ASSOCIATION

The 1983 Social Security Amendments have created a serious and apparently inadvertent problem for certain Ohio hospitals that have converted from governmental control to nonprofit status. There are nineteen such hospitals in Ohio, eight of which have a substantial number of potentially affected employees.

The provision in the amendments (Section 1400 of the Federal Insurance Contributions Act, and amendments thereto, 53 Stat. 175 (1939) 26 U.S. CA. 3101 requiring all employees of nonprofit agencies to participate in Social Security as of January 1, 1984 conflicts with current state statue. Ohio law (O.R.C. 145.01) defines a public employee as anyone hired by a public employer—regardless of the current status of that employer. Individuals covered by the state pension system must retain in that system even though the hospital changed from government to private control.

Approximately 1,000 employees face mandatory double coverage; additionally, the option of converting from political subdivision to nonprofit status is virtually eliminated in Ohio.

We have discussed this problem at the state level, and while the Ohio Legislature is willing to act, a sound solution is beyond their authority.

We do not believe that Congress intended to force mandatory double coverage on any group of employers and employees, but that is the situation we are faced with.

The Ohio Hospital Association has prepared the amendment (to H.R. 3805) which speaks specifically to employees of political subdivision hospitals which have converted to nonprofit control prior to the effective date of the 1983 Social Security Act Amendments (1/1/84). Relief for subsequent conversions will have to be handled at the State level.

I would like to stress that the proposed language deals with a very finite population, that is those hospitals and employees that have exercised their right to convert from political subdivision to nonprofit status prior to the effective date of the '83 amendments.

This group of 1,000 effected individuals will eventually retire or otherwise leave PERS. There is no open door for future egress.

I would stress that we are requesting relief from double coverage—not for nonprofit institutions that have adopted out of Social Security (our amendment would not help that group), but for a group of responsible institutions and employees that are actively seeking to obey the law.

As I stated earlier I do not believe that Congress contemplated this "double coverage" situation, and I would respectfully request your attention to our suggested solution.

Attachments:

Suggested Amendment to Sec. 210(a) of the Social Security Act

List of Voluntary Nonprofit Association Hospitals formerly operated as an Ohio Political Subdivision.

Ohio Revised Code, Section 145.01.

SUGGESTED AMENDMENT TO SECTION 210 OF THE SOCIAL SECURITY ACT

Section 210(a) of the Social Security Act is amended by inserting a new paragraph (20) as follows:

"(20) Service performed in the employ of an Ohio nonprofit organization which has prior to January 1, 1984 contracted to take over a public operated function if (a) the employee is a member of the Ohio Public Employee Retirement System who continues to perform the same or similar duties for the private contracting organization as he performed for the public employer; and (b) the employee remains a member of the Ohio Public Employee Retirement System by virtue of State law."

VOLUNTARY NONPROFIT ASSOCIATION HOSPITALS FORMERLY OPERATED AS AN OHIO POLITICAL SUBDIVISION

Hospital	Year converted	Number of employees covered by PERS	Total number of employees
Mary Rutan Hospital, 205 Palmer Ave., Bellefontaine, Ohio 43311 (Ewing H. Crawfis, Administrator) (Logan County) 513/592-4015	1978	100	302
Lancaster Fairfield Community Hospital, 401 N. Ewing St., Lancaster, Ohio 43130 (Joseph D. McKelvey, Executive Director) (Fairfield County) 614/687-8000	1982	500	546
The Community Hospital of Bedford, 44 Blaine St., Bedford, Ohio 44146 (William E. Polack, Executive Director) (Cuyahoga County) 216/439-2000	1978	137	299
Greenfield Area Medical Center, 545 South St., Greenfield, Ohio 45123 (Mike Williams, Administrator) (Highland County) 513/981-2116	1981	41	98
Madison County Hospital, 210 N. Main St., London, Ohio 43140 (Richard A. Harley, Administrator) (Madison County) 614/852-1372	1975	97	259
Greene Memorial Hospital, 1141 N. Monroe Drive, Xenia, Ohio 45385 (Herman N. Menapace, President) (Greene County) 513/372-8011	1972	84	586
Scioto Memorial Hospital, 1805 27th St., Portsmouth, Ohio 45662 (Lowell E. Thompson, Administrator) (Scioto County) 614/354-7581	1963	3	651
Wadsworth-Rittman Hospital, 195 Wadsworth Road, Wadsworth, Ohio 44281 (William R. Rundle, President) (Medina County) 216/334-1504	1965	5	241

§ 145.01 Definitions.

As used in Chapter 145. of the Revised Code:

(A) "Public employee" means any person holding an office, not elective, under the state or any county, municipal corporation, park district, conservancy district, sanitary district, health district, township, metropolitan housing authority, state retirement board, Ohio historical society, public library, county law library, union cemetery, joint hospital, institutional commissary, state university rotary fund, or board, bureau, commission, council, committee, authority, or administrative body as the same are, or have been, created by action of the general assembly or by the legislative authority of any of the units of local government named in this division, or employed and paid in whole or in part by the state or any of the authorities named in this division in any capacity not covered by section 3307.01 or 3309.01 of the Revised Code. "Public employee" also means one who is a member of the retirement system who continues to perform the same or similar duties under the direction of a contractor who has contracted to take over what before the date of such contract was a publicly operated function. The governmental unit with whom such contract has been made shall be deemed the employer for the purposes of administering Chapter 145. of the Revised Code.

Any civilian employees of the national guard and the air national guard, employed in or with a unit of the Ohio national guard or the Ohio air national guard, except those employed by the national guard bureau, shall be considered as employees of the adjutant general of the state for the purpose of Chapter 145. of the Revised Code, although such employees may be paid by federal funds. "Public employee" means also any person who performs or has performed services under the direction of an employer, as defined in division (D) of this section, notwithstanding his compensation for such services has been or is paid by one other than such employer. Credit for such service shall be included as total service credit, provided, the employee makes the payments required by Chapter 145. of the Revised Code, and his employer makes the payments required by sections 145.48 and 145.51 of the Revised Code.

In all cases of doubt, the public employees retirement board shall determine whether any person is a public employee, and its decision is final.

(B) "Member" means any person included in the membership of the public employees retirement system.

(C) "Head of the department" means the elective or appointive head of the several executive, judicial, and administrative departments, institutions, boards, and commissions of the state and local government as the same are created and defined by the laws of this state or, in case of a charter government, by such charter.

(D) "Employer" means the state or any county, municipal corporation, park district, conservancy district, sanitary district, health district, township, metropolitan housing authority, state retirement board, Ohio historical society, public library, county law library, union cemetery, joint hospital, institutional commissary, state medical college, state university local rotary fund or board, bureau, commission, council, committee, authority, or administrative body as the same are, or have been, created by action of the general assembly or by the legislative authority of any of the units of local government named in this division not covered by section 3307.01 or 3309.01 of the Revised Code. In addition, "employer" means the employer of employees described in division (A) of this section.

(E) "Prior service" means all service as a public employee rendered before January 1, 1935, and all service as an employee of any employer who comes within the state teachers retirement system or of the state public school employees retirement system or of any other retirement system established under the laws of this state rendered prior to January 1, 1935, provided that if the employee claiming such service was employed in any capacity covered by such other system after such other system was established, credit for such service may be allowed by the public employees retirement system only when the employee has made payment, to be computed on the salary earned from the date of appointment to the date membership was established in the public employees retirement system, at the rate in effect at the time of payment, and the employer has made payment of the corresponding full liability as provided by section 145.44 of the Revised Code. "Prior service" also means all service credited for active duty with the armed forces of the United States as provided in section 145.30 of the Revised Code.

If an employee who has been granted prior service credit by the public employees retirement system for service rendered prior to January 1, 1935, as an employee of a board of education, establishes, before retirement, one year or more of contributing service in the state teachers retirement system or school employees retirement system, then such prior service ceases to be the liability of this system.

If the board determines that a position of any member in any calendar year prior to January 1, 1935, was a part-time position, the board shall determine what fractional part of a year's credit shall be allowed by the following formula:

(1) When the member has been either elected

Notice: For late 1982 legislation (passed Nov. 18 to Dec. 31), see 1983 Legislative Bulletin #1 (in Current Material Binder).

(AA) "Deputy sheriff" means any person who is commissioned and employed as a full-time peace officer by the sheriff of any county, and has been so employed since on or before December 31, 1965, and whose primary duties are to preserve the peace, to protect life and property, and to enforce the laws of Ohio; or any person who is or has been commissioned and employed as a peace officer by the sheriff of any county since January 1, 1966 and who has received a certificate attesting to his satisfactory completion of the peace officers training school as required by section 109.77 of the Revised Code and whose primary duties are to preserve the peace, to protect life and property, and to enforce the laws of Ohio.

(BB) "Township constable or police officer in a township police department or district" means any person who is commissioned and employed as a full-time peace officer pursuant to Chapter 505. or 509. of the Revised Code, who has received a certificate attesting to his satisfactory completion of the peace officer training school as required by section 109.77 of the Revised Code, and whose primary duties are to preserve the peace, to protect life and property, and to enforce the laws of this state.

(CC) "Fiduciary" means a person who does any of the following:

(1) Exercises any discretionary authority or control with respect to the management of the system, or with respect to the management or disposition of its assets; or

(2) Renders investment advice for a fee, direct or indirect, with respect to money or property of the system; or

(3) Has any discretionary authority or responsibility in the administration of the system.

A public employee who is making contributions for full credit under division (B), (C), or (E) of section 145.33 of the Revised Code shall be ineligible to make concurrent contributions and receive concurrent credit under division (A) of section 145.33 of the Revised Code.

*HISTORY: 135 v H 505 (Eff 12-27-73); 139 v H 113 (Eff 11-5-81); 139 v H 548, Eff 10-5-82.

Cross-References to Related Sections

Sponsor is required to make contributions, RC § 145.29.6.

Status of employees, RC § 3381.13

See RC § 145.04 which refers to RC § 145.01 et seq.

See RC § 145.11.3 which refers to this chapter.

CASE NOTES AND OAG

1. (1977) The employer of an employee who is classified as a "public employee" under the definition given in RC § 145.01(A) is an employer for the purposes of RC § 145.32, governing compulsory retirement, even though that employer is not a governmental unit and is therefore not an employer for the purpose of administering RC Chapter 145. Brown v. Toledo Mental Hygiene Clinic, 63 OApp2d 73, 17 OO3d 258, 409 NE2d 251.

2. (1980) A county board of mental retardation is an "employer" for purposes of RC § 145.01 D. and as such must bear financial responsibility for any delinquent contributions owed PERS pursuant to RC §§ 145.48(F) and 145.48.3 which arise out of employment with the board. OAG No. 80-063.

[§ 145.01.1] § 145.011 Other public employees included.

In addition to the membership of the public employees retirement system as prescribed in division (A) of section 145.01 of the Revised Code, there shall be included in such membership the nonteaching employees of the Cleveland state university, the medical college of Ohio at Toledo, and the northeastern Ohio universities college of medicine, notwithstanding Chapter 3309. of the Revised Code. Such employees are included in the definition of member as used in Chapter 145. of the Revised Code. The university and colleges shall be subject to the obligations imposed by Chapter 145. of the Revised Code.

*HISTORY: 137 v H 813, Eff 1-4-79.

[§ 145.01.2] § 145.012 Exception.

"Public employer" as defined in division (A) of section 145.01 of the Revised Code does not include any person included in section 3307.012 [3307.01.2] of the Revised Code.

No inmate of a correctional or penal institution operated by the department of rehabilitation and correction, no patient in a hospital for the mentally ill or criminally insane operated by the department of mental health, no resident in an institution for the mentally retarded operated by the department of mental retardation and developmental disabilities, no resident admitted as a patient of the Ohio veterans' home at Sandusky, and no resident of a county home shall be considered as a public employee for the purpose of establishing membership or calculating service credit or benefits under this chapter. Nothing in this section shall be construed to affect any service credit attained by any person who was a public employee before becoming an inmate, patient, or resident at any institution listed in this section, or the payment of any benefit for which such a person or his beneficiaries would otherwise be eligible.

*HISTORY: 135 v H 38 (Eff 8-29-79); 135 v H 900, Eff 7-1-80.

The effective date of HB 900 is set by section 3 of the act.

§ 145.02 Exclusions from membership; payment required to acquire service credit in PERS.

(A) Notwithstanding section 145.03 of the Revised Code, any public employee who is contributing to or is receiving disability benefits from a municipal retirement system established prior to June 30, 1938, or who has been granted a disability

Mr. GIBBONS. Are there any questions?

Mr. DUNCAN. I have no questions. Thank you, Mr. Weimer, and Mr. Owen.

Mr. JACOBS. I have no questions. Thank you both for your testimony.

Mr. GIBBONS. Our last witness is from the Illinois Petroleum Marketers Association, Mr. Gregg Potvin.

STATEMENT OF GREGG POTVIN, COUNSEL, ILLINOIS PETROLEUM MARKETERS ASSOCIATION

Mr. POTVIN. Mr. Chairman, first of all, I would like to thank the Chair and the committee for the opportunity to present these views. I was not informed of the opportunity until last evening, and obtained permission from the staff to proceed orally.

If I might have such period of time as the Chair deems appropriate to submit a written statement——

Mr. GIBBONS. Yes, sir. If you will just stay in contact with the staff, they will tell you when we are going to close this record.

Mr. POTVIN. Thank you, Mr. Chairman.

These views are presented on behalf of the Illinois Petroleum Marketers Association, the Texas Oil Marketers Association, and the National Association of Texaco Wholesalers. They also represent the views of the National Oil Jobbers Council.

There are several points. The first is that the payment date on remittances of the tax on gasoline and diesel fuel currently are 5 days apart. On gasoline, they remit twice a month.

The gasoline tax is, of course, a manufacturer's tax. Wholesalers are allowed to buy the material extax from the refiner, and add the tax when they sell it either to a direct consumption customer or a retail reseller. It is just causing havoc for these small businessmen, many of which are literally ma and pa operations, to have four remittance dates a month.

Two remittance dates a month—each for both gasoline and diesel fuel would serve IRS's interests with at least equal force. It may sound like a small thing, but on behalf of the many thousands of oil wholesalers in the country, we certainly hope that consideration be given to that.

The next point, and one which was commended, in fact, recommended to the Congress by the annual IRS report issued at the close of last year, is this: That in light of diesel fuel tax being a consumption tax, wholesalers are not allowed to sell on a tax-collected basis to resellers.

Now, they can do so to direct consumption accounts if that consumer files an affidavit stating that it is primarily for consumption on highway.

IRS has recommended and we urgently request that wholesalers and retail dealers be allowed to agree that the wholesaler sell it tax included to that retailer. There are several reasons that commend this.

First, simplicity—it will eliminate a great deal of paperwork. Second, IRS will receive the money faster. It would be remitted twice a month, and it would not have to wait until the sale to an ultimate consumer.

And, of course, the time lags on occasion can run a month or more. Last, and perhaps more important, it is a far more sure and certain method of collection. The wholesaler population is relatively stable. The dealer population is extremely volatile and when a dealer leaves a station, whether you will be able to trace that individual or not is an awfully good question.

Currently, what has been happening is occasionally, a wholesaler will get appalled that the tax just isn't being paid. So he will add it to the cost of the fuel, collect it from the dealer, and then get a $500 fine as thanks. That is clearly unequitable.

It has been recommended by IRS and I think the logic of it is there. I think that it will get more money, or a more certain basis quicker and more easily for the Federal tax coffers.

It is my impression that the trucking industry has, to a degree, backed away from its effort to have a two-tier tax structure on diesel fuel under which a family automobile motorist would pay one level of tax and truckers would pay another.

On behalf of marketers, I would like to make a plea to this committee that it not adopt a two-tier system. Mr. Chairman, I cannot tell you how difficult this would be. Buying a gallon of gasoline for the family automobile seems like a rather simple transaction, or at least we hope it does. If our members are giving you good service, it should.

In actuality, it is not simple from the sellers point of view. There are four grades of fuel, leaded, two grades of unleaded, diesel fuel, and perhaps in many markets ethanol enhanced as well if competition requires it, so that is at least four, and maybe five pumps.

Full serve and self serve. Each takes a dispenser for eacy grade.

Now you have got either 8 or 10. Cash price, credit price. They have to be handled differently. This doubles it again. Now, you have either 16 or 20 and that is before you even talk about a two-tiered tax.

So we can't do it. We just can't train staff, the hardware, the software is not up to it. We don't have enough pumps or tanks to dedicate yet another one to another dimension of complexity.

I think that my final word on it is quite brief. Don't do it.

Now, I have two more points that will be about one sentence a piece, Mr. Chairman.

One, at the present time, IRS can put a tax lien on a dealer location the dealer leaves without paying the tax and if the wholesaler doesn't pay the tax you put a lien on the station.

In truth, the wholesaler has to pay it off or lose the station, but he is not able to write it off for tax purposes. Clearly, simple equity demands that he should be allowed to do so.

Finally, as you know, we live in a world of rapidly evolving new technology. Motor fuel is being created from an ever-growing number of sources. In recent years, we have seen increased use of such things as compressed natural gas and all sorts of exotic blends.

We would ask only this, Mr. Chairman: That absent any compelling reason from other strands of public policy such as exists in the case of ethanol, a renewable fuel, that there be a fungible view of it. If it is used as motor fuel, treat it the same, because if you don't, you are going to set up competitive anomalies that would be highly

destructive in the marketplace. You will have people constantly desiring new blends that aren't on the list to be taxed just to gain the competitive advantage.

It is not fair to people in our marketplace and it is not fair to other consumers and other taxpayers. We would urge simple uniformity, although we don't want to appear to be in the position of opposing in any way the preference given certain renewable fuels.

Thank you very much, Mr. Chairman.

Mr. GIBBONS. Well, thank you, sir.

Let me ask you, is what you are saying a general consensus of your industry?

Mr. POTVIN. I speak, of course, only for the independent marketing sector, and I can report to you, Mr. Chairman, that it goes beyond consensus. I think what we are talking here is unanimity, sir.

Mr. GIBBONS. Do you know how the Congress got involved in setting this up as complicated as it is in that first part of your statement?

Mr. POTVIN. I think unintentionally, sort of a bite at a time, some of it in legislation, some of it by regulation. IRS staff has been extremely cooperative on this. We have had many meetings with them and they concur that the ability for a retailer and a wholesaler to agree that the wholesaler will remit the diesel tax should occur, but they say, unless they are legislatively authorized, they can't do it.

So it has not been a matter of intent, I am sure.

Mr. GIBBONS. I asked staff while you were talking why we set it up like we did, and they said, well, because they were under the impression that someone in your industry had asked that it be done this way.

You make good sense. I don't know why we set it up this way, except somebody must have opportuned us to do it this way. I wonder if you could give us any insight?

Mr. POTVIN. No; I can't, sir. I have been around the Hill and petroleum matters for awhile. I served with Wright Patman in 1961 as general counsel of the House Small Business Committee, and became somewhat enamored with petroleum work, but much of it happened before my tour, sir.

Mr. GIBBONS. All right. Well, I think you make some good suggestions and we will just keep in contact with the staff about the date of closing of the record and we will remember your words and try to do something about it.

Mr. POTVIN. Thank you, Mr. Chairman.

[The following letters were subsequently received:]

ILLINOIS PETROLEUM MARKETERS ASSOCIATION,
Springfield, Ill., September 29, 1983.

Hon. DANIEL ROSTENKOWSKI,
Chairman, House Ways and Means Committee,
Rayburn House Office Building,
Washington, D.C.

DEAR MR. CHAIRMAN: I received a call a few days ago concerning the hearing on HR 3805, which is the bill that pertains to technical corrections to the Surface Transportation Act of 1982 (PL 97-424). I was very sorry that I was unable to attend this hearing, because I had some very important points that needed to be stressed to the committee. It so happened that the very day that the committee was holding the

hearing, we were having a seminar here in Springfield for our members, and it was mandatory that I attend.

I contacted our Washington Attorney, Mr. Gregg Potvin, who appeared in my place and gave the committee an insight we believe was needed to correct some of the problems with the Surface Transportation Act. I appreciate your making the call to us, and I just wish I would have been able to be present.

We do want to reiterate a couple of things that the committee should take into consideration in amending the bill. First of all, I hope that you could extend the twice-monthly payment remittance schedule for diesel fuel as well as gasoline. Right now you have the diesel fuel tax due on the 9th and the 24th of the month, and you have the gasoline/gasohol tax due on the 14th and the 29th of the month. This causes our marketers a great amount of confusion, especially the smaller marketers. Many of our members are small operators, who many times either have their wife or an office girl who also acts as bookkeeper. Great confusion ensues when they have to make up four checks monthly for the federal tax. This unnecessary paper work burden could be quickly eliminated if we could put the tax due dates for gasoline and diesel all on the same dates. It isn't asking for much and could be quickly handled. We are certain that it wouldn't cost the Federal Government any huge sums of money. If they do lose some funds, due to the extra five days, they could quickly make it up by closing the loop holes in the enforcement of the Federal Motor Fuel Tax. Hopefully, some action can be taken to simplify and alleviate the bookkeeping problem on the Federal Motor Fuel Tax, and making only two times a month the taxes would be paid. We know it would be greatly appreciated by all marketers throughout the United States

We are glad to see that the words "wire transfer" are probably going to be eliminated from PL 97-424. I was in touch with Bill Cunningham of your office about this quite often back in April. Very few down state banks are equipped to handle wire transfers. It is working out very well the way the treasury is presently handling it. Most banks have an account with the U.S. Treasury. Marketers just deposit their money on the due date and, the bank transfers the tax money to the treasury account.

As I mentioned earlier, any funds that you would lose in making the dates of diesel fuel and the gasoline/gasohol all the same, could be quickly made up by changing the ways that we have of collecting the Federal Motor Fuel Tax. Allow the retail dealer and commercial accounts to consent to the marketer collecting his tax.

We know of many instances where people claim they have a 637 form (the form needed to be a collector of Federal Excise Tax on gasoline and diesel fuel). We find that many people who are claiming that they have a 637 Form when in essence they don't. They are giving their Federal Identification Number that the IRS has issued for income tax purposes. Of those that do have 637 forms, many do not even qualify as being tax exempt. Yet, they tell the marketer when they are buying from them that they are tax exempt. We have attempted to straighten out this problem in this state, but I still know that there are still many violations that remain undetected. I am also sure that there are some commercial accounts that are buying diesel fuel tax free and not remitting the tax when they use it for over-the-highway purposes. This is also very true in agricultural business and this applies to Illinois and all states that have a large agriculture industry. This alone would more than save you the million and half dollars that one man at the IRS said it would take to change the collection dates to make them the same for both products.

We have found also that many of the dealers would prefer to have their jobber/supplier collect and remit the diesel fuel the same way that the Federal Excise Tax on gasoline is handled. Such a system is less burdensome on a small dealer who can consent to this arrangement and it certainly makes it a lot easier for the IRS to administrate, because it would result in fewer accounts that they have to watch.

This leads into another problem. Many of these dealers are only in business for maybe three to six months and then they are gone . . . without having paid their excise tax. Subsequently, excise tax liens are put on these service stations. The only way that a jobber can get a station reopened is to pay off the lien that the previous dealer had with the Federal Government. I think an amendment should be adopted that would permit the jobber to collect the Federal Motor Fuel Tax or else allow him to write off these tax liens as bad debts on their income tax payments to the IRS.

Frankly, since this tax went up to 9¢ per gallon, it makes it very enticing to cheat a little. When you could have a 9¢ advantage over one of your competitors, it is a great break in this very competitive petroleum market. Therefore, anything that we can do to tighten up and make sure that the Federal Government is collecting the taxes due to them, I think we should work for and strive to see that it is done. I

know that most of the marketers that I have talked with are very much in favor of the points that I have listed above in this letter. They feel that this would help in the avoidance schemes and would also help the IRS in tracking down culprits who are cheating on the Federal Tax on gasoline/gasohol and diesel.

Very truly yours,

WILLIAM R. DEUTSCH,
Executive Vice President.

TEXAS OIL MARKETERS ASSOCIATION,
Austin, Tex. September 29, 1983.

Hon. J.J. PICKLE,
U.S. Congress,
Cannon House Office Building,
Washington, D.C.

DEAR CONGRESSMAN PICKLE: Petroleum marketers in Texas and across the country appreciated your assistance in extending the twice a month tax remittance schedule for payment of the federal gasoline excise tax by five days when Congress approved the Surface Transportation Act of 1982. This change has helped our small members cash flow problems as a result of the 5¢ increase in the federal motor fuel tax.

It is my understanding that the House Ways and Means Committee is now considering HR 3805, the Technical Corrections Bill to the Highway Revenue Act.

The Texas Oil Marketers Association would respectfully urge your consideration of amendments to HR 3805 that would revise the collection and remittance of the diesel fuel taxes. Our first area of concern is that when Congress approved the five day extendsion of gasoline, it did not extend the twice monthly tax remittance schedule for diesel fuel. Small business petroleum marketers have encountered cash flow problems as a result of the increase in the diesel fuel tax effective April 1. Many of these marketers enter into an agreement with commercial users of diesel fuel to allow them to collect and remit the tax on their behalf. Thus, the diesel fuel tax is often paid to the federal government before it is collected from the purchaser. This creates the same "float" problem that Congress was attempting to alleviate for gasoline federal tax remittance.

Additonally, when the Surface Transportation Act allowed the five day extension for gasoline, it resulted in petroleum marketers having to submit their taxes on four different dates, because diesel fuel was required to be submitted on the 9th and 25th, and gasoline on the 14th and 29th. This is an unnecessary paperwork burden on small jobbers and by extending the remittance schedule for diesel fuel to match the gasoline tax payment schedule, Congress would alleviate and simplify the bookkeeping snarl that was inadvertently created for marketers.

TOMA has also been working with the National Oil Jobbers Council in support of an amendment that would allow jobbers to enter into an agreement with a dealer whereby the jobber would collect the diesel fuel tax on his behalf. Under present law, only end-user accounts can have marketers assessing them for the excise taxes. An amendment to the Technical Corrections Bill would allow dealers and jobbers to enter into an agreement whereby their jobber/supplier would assess the tax when the product is laid-in to the dealers inventory.

For the past two years, TOMA has been meeting with staff members of the Department of the Treasury and the Internal Revenue Service Explaining that many petroleum marketers have historically collected the diesel fuel on behalf of service station dealers and remitted it to the IRS. We explained that it was much more efficient to have 15,000 distributors submitting the tax, rather than 150,000 retailers. In a report published by the Department of the Treasury in December, 1982, the agency has endorsed our recommendation to "allow distributor/retailer agreements to have the distributor report and pay the tax for retailers and users." This was published in the "Final Report Of The Study Of Highway Excise Tax Structure," published by the Secretary of the Treasury in December, 1982.

The report points out that while it has been a common industry practice for marketers to collect the tax on behalf of service station dealers, under existing statutes it is illegal and the motor fuel tax code must be changed before IRS can recognize the validity of such agreements.

Our Association is also supportive of efforts of the National Oil Jobbers Council to eliminate the words "wire transfer" from the Highway Revenue Act. When the bill was under discussion, language was included to require marketers to remit the gasoline tax by "wire transfer." This word initially created a great deal of confusion

within the petroleum and banking community, and IRS is attempting to clarify their regulation. Unfortunately, confusion still exists and we feel it would be to everyone's advantage to eliminate the words from the legislation. TOMA also supports NOJC's recommendation that marketers be allowed to write off bad debt excise tax payments and is opposed to recent discussion of a two-tiered diesel tax system because of a serious problem for marketer accounting and for the enforcement at the retail pump.

Marketers are very grateful to you for your assistance in obtaining the five day extension for the gasoline tax remittance. We would sincerely appreciate your support and assistance in the areas we have outlined when the Technical Corrections Bill is considered by the House Ways and Means Committee. Our Washington Counsel, Gregg Potvin, recently appeared before the Committee and outlined many of these areas. By copy of this letter, I am asking Gregg to submit this letter for the record of the hearings on HR 3805.

If you or any of your staff has any questions on our comments, please feel free to call.

Cordially,

DAVE FELLERS, CAE,
Executive Vice President.

Mr. GIBBONS. Thank you.

This concludes the hearing for today, and the committee is adjourned.

[Whereupon, at 11:40 a.m., the hearing was adjourned.]

[Submissions for the record follow:]

OFFICE OF PERSONNEL MANAGEMENT,
Washington, D.C., September 23, 1983.

Hon. DAN ROSTENKOWSKI,
Chairman, Committee on Ways and Means,
House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: We understand that the Ways and Means Committee is considering H.R. 3805, the "Technical Corrections Act of 1983." The Office of Personel Management is particularly interested in title IV of the bill insofar as it affects Social Security coverage for certain Federal employees, beginning January 1, 1984, and we hope that the following comments will be helpful to the Committee in your consideration of this bill.

We note that section 401(h) of H.R. 3805 would amend section 210(a)(5)(B) of the Social Security Act, as amended by section 101(a)(1) of Public Law 98-21, to provide that Federal employees will continue to be excluded from Social Security coverage after December 31, 1983, only if they have been continuously employed since December 31, 1983, in a Federal position not covered by Social Security. Section 403(e)(1)(B) of the bill would make an identical amendment to section 3121(b)(5)(B) of the Internal Revenue Code. These changes are intended to correct a "loophole" left by Public Law 98-21, which would have allowed certain individuals who, before January 1, 1984, are performing military service or civilian service under a temporary appointment to avoid Social Security coverage if, after December 31, 1983, they become employed under a permanent appointment in the Federal civilian service. If this loophole is not corrected, an individual beginning military service before the end of this year, for example, could spend an entire twenty-year career in the military and then begin a civilian career in the Government, at which time he or she would be exempt from Social Security and covered only under the Civil Service Retirement System. This result is clearly inconsistent with the intent of the amendments to the coverage provisions of the Social Security Act that were effected by Public Law 98-21. Accordingly, we support, in principle, section 401(h) of H.R. 3805.

However, two technical deficiencies in this provision should be noted. First, the use of the present tense in the phrase "performing service which is excluded from the term 'employment' in the employ of the United States or an instrumentality thereof" (emphasis added) in subparagraph (B) of section 210(a)(5) of the Social Security Act, as it would be amended, is confusing. The service to which this phrase refers is really the same as the service described in subparagraph (A), i.e., service which "would be excluded from the term 'employment' for purposes of this title if the provisions of paragraph (5) and (6) of this subsection as in effect in January 1983 had remained in effect." Therefore, it would seem clearer to simply amend section 210(a)(5)(B) by striking out "in the employ of the United States or an instrumentality thereof" and inserting in lieu thereof "performing service described in subpara-

graph (A) of this paragraph." Also, section 401(h) of the bill amends section 210(a)(5)(B) of the Social Security Act in only one of two places where an amendment is needed. "Performing service described in subparagraph (A) of this paragraph" should also be inserted in lieu of "in the employ of the United States or an instrumentality thereof" the second time it appears in subparagraph (B). Conforming changes should, of course, also be made to section 3121(b)(5)(B) of the Internal Revenue Code.

Another problem we note is that section 210(a)(5)(ii)(I) of the Social Security Act, as amended by section 101(a)(1) of Public Law 98-21, provides that no one employed "in a postion placed in the Executive schedule under section 5312 through 5317 of title 5, United States Code," shall be excluded from Social Security coverage. However, some 300 executive positions (primarily Presidential appointees serving as agency heads and principal officers) are not listed in the Executive Schedule, even though their pay is fixed by law at a rate equivalent to one of the levels of the Executive Schedule, and they are for all practical purposes indistinguishable from those positions that are listed in the Executive Schedule. In addition, some positions that remain listed in the Executive Schedule in 5 U.S.C. 5312-5317 are actually now in the Senior Executive Service (SES). It does not appear that Congress intended to cover career employees in SES positions.

Finally, it is unclear under current law whether a current career member of the SES who accepts a Presidential appointment after December 31, 1983, would be covered under Social Security. These individuals, under 5 U.S.C. 3392(c), are permitted to continue to be treated, for purposes of pay and benefits, as career SES members, even though they are serving as Presidential appointees. However, Public Law 98-21 creates questions about their status under Social Security.

These inconsistencies could be eliminated by amending both section 210(a)(5)(ii)(I) of the Social Security Act and section 3121(b)(5)(ii)(I) of the Internal Revenue Code, as amended by section 101(a) and (b), respectively, of Public Law 98-21, to read as follows:

"(I) in a position in the executive branch which is paid at a rate of the Executive Schedule under sections 5312 through 5317 of title 5, United States Code, or other provision of law (other than a position occupied by a career appointee in the Senior Executive Service, the Senior Foreign Service, or a comparable personnel system, or a position for which the rate of basic pay is limited to that of level V of the Executive Schedule under section 5308 of title 5, United States Code)".

These changes should make the amendments effected by Public Law 98-21 more equitable and consistant. I hope the Committee will give them favorable consideration.

The Office of Management and Budget advises that there is no objection to the submission of this report from the standpoint of the Administration's program.

Sincerely,

DONALD J. DEVINE, *Director.*

ASSOCIATION FOR ADVANCED LIFE UNDERWRITING,
Washington, D.C., September 28, 1983.

JOHN J. SALMON,
Chief Counsel, Committee on Ways and Means,
House of Representatives, Washington, D.C.

DEAR MR. SALMON: On behalf of the Association for Advanced Life Underwriting (AALU) and the National Association of Life Underwriters (NALU), we are submitting these comments regarding provisions of H.R. 3805, the Technical Corrections Act of 1983.

AALU is a nationwide organization of approximately 1,100 members specializing in one or more fields of advanced life underwriting. Collectively our members are responsible for annual sales of life insurance in excess of $2 billion, mostly in circumstances involving complex factual situations and often dealing with qualified retirement plans and similar employee compensation techniques. Much of the work performed by our members is with small businesses.

The National Association of Life Underwriters, which has a membership of 1,022 state and local associations with combined individual membership of over 120,000 life insurance agents, general agents and managers, joins AALU in the submission of these comments.

Our comments regarding the provisions of H.R. 3805 (the Act) are as follows:

ROLLOVERS—SECTION 103(c)(3) OF THE ACT

Section 101(c)(3) of the Act would modify section 402(a)(5)(E)(ii) of the Internal Revenue Code to prohibit the rollover to a qualified retirement plan or an annuity plan of any amount attributable to contributions made on behalf of an employee while he was a key employee in a top-heavy plan. The presumed purpose of this provision is to prevent key employees from escaping the restrictions of the top-heavy rules by making rollovers to non-top-heavy plans.

The provision is inappropriate as drafted. The net effect of the provision is to prevent key employees from being able to make rollovers into other qualified plans and limits their rollover choice to individual retirement accounts, annuities and bonds. While rollovers to individual retirement accounts, annuities and bonds are desirable, there are substantial tax detriments to making rollovers to these types of IRAs rather than making rollovers to other qualified plans. For example, the special 10-year forward averaging treatment under section 402(e)(4) of the Code is no longer available if the distribution is from an IRA.

The proposed restriction in the Act is overly broad. The purpose can be accomplished by prohibiting rollovers that will avoid the top-heavy restriction. A key employee could make a rollover from one top-heavy plan to another top-heavy plan and would not evade the top-heavy restrictions yet at the same time would be entitled to the favorable tax treatment associated with qualified retirement plans. The Technical Corrections Act should not add additional punitive rules for key employees in top-heavy plans under the guise of a technical correction. If the purpose is merely to prevent an evasion of the top-heavy restrictions then the provision should be redrafted to limit it precisely to that situation.

SIMPLIFIED EMPLOYEE PENSION LIMITATION—SECTION 103(d)(2) OF THE ACT

Section 103(d)(2) of the Act corrects the limitation applicable to simplified employee pensions (SEPs) and inserts a new limitation that states that the allowable contribution is an amount not in excess of the limitation in effect under section 415(c)(1)(A).

We are uncertain whether the statutory language regarding the limitation "in effect" under section 415(c)(1)(A) would include any cost-of-living adjustments that are made by reason of section 415(d) to the limit under section 415(c)(1)(A). Since we understand that these cost-of-living adustment should be incorporated into the limitation, we suggest that the language be modified to make it clear that the section 415(d) cost-of-living increases are included in the limitation under section 415(c)(1)(A).

DEFINITION OF KEY EMPLOYEE—SECTION 103(f)(1) OF THE ACT

Section 103(f)(1)(A) of the Act modify the definition of key employee under section 416(i)(1) to make any employee of the employer potentially a key employee rather than limit it to participants in the plan.

This change appears to be a broadening of the definition of key employee that goes beyond a mere technical correction. This would allow non-participating employees to be included as key employees and may thereby potentially expand the application of the top-heavy rules. Under the statute as currently enacted, it is clear that a person must be a plan participant in order to be a key employee. It seems beyond the scope of a technical corrections bill to expand that definition. We therefore recommend that the current definition be retained in this legislation.

SIMPLIFIED EMPLOYEE PENSION DEFINITION—SECTION 103(f)(2) OF THE ACT

Section 103(f)(2) of the Act modifies the definition of simplified employee pension (SEP) in section 408(k)(1) of the Internal Revenue Code. As modified, the definition would appear to require that SEPs that are top-heavy meet the requirements of section 416(c)(2) as to minimum contributions that must be provided.

Under current law it is clear that the top-heavy rules of section 416 are only applicable to qualified plans. While as a policy matter it may be appropriate to extend these rules to non-qualified plans such as SEPs, it is again beyond the scope of a technical corrections bill to make these kinds of policy judgments. The Act should be restricted to technical corrections of the legislation and not to substantive expansions of the bill to include non-technical changes.

As proposed, this provision on SEPs would have a major adverse impact on existing SEPs and the adoption of SEPs in the future. It would extend one of the more oneous provisions of the top-heavy rules to SEPs for the first time. Yet the provision has not been debated by Congress, nor has it been considered by the public in any

sense. Instead, it has been included as part of a technical corrections bill which is presumed not to contain major policy changes.

This legislative approach is not appropriate and this provision should be deleted from the Act since it is beyond the scope of the legislation. If it desirable to make policy changes that would have an adverse impact on SEPs, it should be done as part of separate legislation that will consider the substantive impact of these changes.

TERMINATED PLANS—SECTION 103(f)(4) OF THE ACT

Section 103(f)(4) of the Act would modify the provisions of section 416(g)(3) of the Code to require that distributions under certain terminated plans be taken into account in determining the top-heaviness of a plan. The termination distributions that would have to be taken into consideration are those made in the last five years under a plan that would have been included in an aggregation group had it been in existence.

Again, this provision appears to be a substantive policy change that expands the reach of the top-heavy rules of section 416. It is beyond a mere technical correction and incorporates a broadening of the statute that is inappropriate for a technical corrections bill. We therefore request that the provision be deleted from this bill and, if appropriate, include it as part of separate legislation to consider further expansion of the top-heavy rules.

QUALIFIED DEPENDENTS—SECTION 103(g)(2) OF THE ACT

Section 103(g)(2) of the Act would provide an additional exception to the five-year post-death payout requirement of section 401(a)(9) of the Code for qualified dependents. Under this rule, "qualified dependents" would be eligible to receive distributions for more than five years after the death of the employee.

Initially we should note our objection to the provisions of section 401(a)(9). When TEFRA was enacted, this provision was described as a mere codification of existing law. See Conference Report at 631. In fact, however, the provision constitutes a major change in existing law in that it eliminates the ability of dependents and others to receive annuities after the death of a participant.

Having hastily restricted post-death annuities, this provision would attempt to retreat to a limited extent to permit certain qualified dependents, for example, children under the age of 22 and disabled children, to receive payments that extend beyond five years.

While we support the concept of expanding the exceptions to section 401(a)(9), we feel that it would be more appropriate to expand section 401(a)(9) even further. Section 401(a)(9) should be modified to return to the old law rule permitting annuities to be paid following the death of a participant. The rules on qualified dependents add two statutory pages of additional complexity. This additional detail and complexity is not necessary and will further complicate an already over-burdened set of rules regarding qualified plans. The so-called abuse present, i.e., the deferral of income tax liability, has not been a major problem in the past and does not warrant the added complexity incorporated in this provision. Section 401(a)(9) should simply be rolled back to permit annuities to be made, at least to family members.

ROWAN DECISION—SECTION 402(g) OF THE ACT

Section 402(g) of the Act would modify section 327(d) of the Social Security Amendments of 1983 (it should be section 328(d)) to change the effective date of the provisions relating to the *Rowan* decision. In essence, the Act would change the effective date of the *Rowan* decision provision from remuneration paid after December 31, 1983 to remuneration paid after March 4, 1983 and to remuneration paid on or before the date the employer treated these amounts as wages.

Again, a substantive modification of the provisions of an act is being made under the guise of a technical correction. This change in the effective date of the provisions relating to the *Rowan* decision should not be modified without a substantive hearing on the merits of the matter. It is inappropriate for inclusion in a technical corrections bill. The provision should be deleted from this bill and left to future substantive legislation.

Respectfully submitted,

GERALD H. SHERMAN, *Counsel, AALU.*
STUART M. LEWIS, *Counsel, AALU.*

STATEMENT OF JOHN A. D. COOPER, M.D., PRESIDENT, ASSOCIATION OF AMERICAN MEDICAL COLLEGES

The Social Security Amendments of 1983 dramatically changed the way in which Medicare pays for hospital services. I am pleased that the Committee, in a very expedited fashion, has provided a forum to present and discuss problems with the implementation of the new Medicare payment method. There are unintended adverse consequences which could result from this payment system, and I urge the Subcommittee to monitor its implementation and be willing to make modifications in the law when necessary. I hope that these proposed technical amendments indicate the Committee's willingness to make necessary changes as the prospective payment system comes to fruition.

With regard to the proposed technical amendments, I would like to call to your attention two issues specifically addressed in H. R. 3805 and four other issues related to the way in which the Department of Health and Human Services has opted to implement prospective pricing. The issues regarding the proposed technical amendments that I would like to discuss are: (1) the continued existence of PSROs, and (2) the acceleration to national prospective pricing. The other issues I wish to raise are: (1) the hospital's ability to appeal certain contested items, (2) the computation of the area wage index, and (3) the lack of an exception or adjustment for certain types of hospitals as required in the Social Security Amendments Act, and (4) the governing board composition of the PROs.

PEER REVIEW ORGANIZATIONS AND PROFESSIONAL STANDARDS REVIEW ORGANIZATIONS

One of the proposed amendments would mandate that Professional Standards Review Organizations (PSROs) function as Peer Review Organizations (PROs) until such time as a PRO is designated in a community. Another provision of the proposed technical amendment would require that exempt hospitals contract with the PROs just as if they were included in the DRG payment system. The AAMC has long supported PSROs as a needed means of quality assurance and utilization review. We support their successor organizations, the PROs, with additional vigor because the incentives in the DRG payment system could lead to a diminished interest in quality of care in some hospitals. Thus, we support the proposed technical amendment to extend the operation of PSROs and to require exempt hospitals to contract with the PROs.

I would like to bring to your attention two other issues regarding this quality assurance and review function. First, in the past, hospitals have been allowed to conduct their own reviews under a "delegated" status. The wording of the current law would preclude hospitals from being so delegated. Many hospitals must perform these review functions in order to maintain their own internal standards of quality as well as to conform to the requirements of accreditation bodies such as the Joint Commission on Accreditation of Hospitals (JCAH). To require that the PRO conduct similar reviews in a hospital already conducting reviews would be unnecessary duplication. I urge you to amend the legislation to allow hospitals to be delegated the authority to conduct their own reviews, which could be monitored by the PRO.

Additionally, the Department of Health and Human Services has interpreted the Social Security Amendment Act to read that the governing board of the PRO may not include any person with administrative responsibilities in a hospital or hospital association. In so doing, HHS is excluding from possible membership on the board a number of people who would bring expertise and a different perspective to the deliberations of the governing board. Clearly, there is a concern that the PRO board not be dominated by the hospitals or hospital associations; however, this purpose can be accomplished by simply restricting the number or the percentage of the board that may be hospital or hospital association personnel. Limited participation of hospital personnel has not been a problem in the operation of the PSRO program. I hope that you will instruct HHS to change its interpretation.

ACCELERATION TO NATIONAL PROSPECTIVE PRICING

When Congress adopted the changes in how Medicare will pay for hospital services, it allowed a three year transition period during which hospitals are provided an opportunity to adapt their practices to conform to the new incentives in the payment system. During these three years, the price paid to a hospital changes gradual-

ly from being based largely on the hospital's own prior cost experience to a rate based wholly on the average experience of hospitals across the nation, separating only the urban and rural hospitals. The way in which HHS has proposed making this transition for hospitals would place hospitals with a fiscal year beginning on any date other than October 1 at a disadvantage compared to those whose fiscal year does begin on that day. HHS would change the blend between national and regional rates for hospitals on October 1 of each of the transition years. This would mean that a hospital whose fiscal year began on July 1 would experience a rate based 75 percent on its own historical cost and 25 percent on the regional average costs of hospitals from July 1 through October 1 of 1984 and then would receive 75 percent of its payment based on its own hospital costs, 18.75 percent based on the regional average rate, and 6.25 percent based on the national average rate from October through June 30. Thus, the July 1 hospital is allowed little time to adapt to the regional price before it is pushed to begin adapting to the national price, while the hospital whose fiscal year began October 1 had a whole year to adjust its practices to conform to those of the region. Your proposed technical amendment (Section 411 (b)(1) of H.R. 3805) would cement this interpretation of the transition periods, and we cannot support it.

OTHER ISSUES

In addition to the technical amendments currently under construction, there are some other issues I wish to raise.

Appeals

HHS has allowed no appeal of the hospital's base year case mix index or base year cost in computing the payment rates. Under the Tax Equity and Fiscal Responsibility Act (TEFRA), a hospital whose case mix index was incorrectly calculated by HHS was allowed to submit a full year's worth of data in order to have its case mix index recomputed. This same consideration should be given under the prospective payment scheme for hospitals that suspect that either 20 percent sampling from the MedPar files does not adequately represent its true case mix or for hospitals whose case mix has changed between 1981 and the present due to inclusion of new members on the medical staff or a change in the patient population served by the hospital. Similarly, hospitals which settle appeals of their 1981 base year costs and are allowed additional costs related to a disputed item should be allowed to include those costs in their base for payment in the prospective payment transition years. Otherwise, the hospital is being wrongfully denied costs which either HHS or the courts have decided are reasonable.

Area wage index

To convert published per case prices to prices used by individual hospitals, a wage index is applied. In the regulation, HHS has used the Primary Metropolitan Statistical Area categories recently revised by the Office of Management and Budget. Clearly, the use of the PMSAs reflects real differences in wage patterns in large urban areas. It does not, however, fully reflect the higher wage costs generally paid in the central city. For example, the "Chicago, Illinois" number is for three entire counties rather than the city of Chicago itself. This penalizes hospitals in the city of Chicago and rewards suburban hospitals. Therefore, the AAMC recommends that wage indices for the core central city in consolidated metropolitan statistical areas be added.

Adjustments

In the prospective payment legislation, Congress directed the Secretary of Health and Human Services to make ". . . such exceptions and adjustments to the payment amounts established under this subsection as the Secretary deems appropriate to take into account the special needs of regional and national referral centers, . . . and of public or other hospitals that serve a significantly disproportionate number of patients who have low income or are entitled to benefits under Part A of this title (i.e., Medicare)." The Secretary is also provided authority to adjust the payment amount for ". . . hospitals involved extensively in treatment for and research on cancer." To make such adjustments, two regulatory components must be specified: (1) a definition of the criteria a hospital must satisfy to qualify for the adjustment and (2) a methodology, means, or procedure for altering the amount otherwise payable. In the September 1 regulations, HHS proposes qualification criteria which often seem to undermine Congressional intent and fail to provide, in some categories, for an adjustment if hospitals should qualify.

HHS's proposal that urban referral centers must have 60 percent of all Medicare patients reside 100 miles from the hospital or out-of-state, whichever is greater, virtually prohibits any urban hospital from being categorized as a referral center. The Congressional intent to assist referral centers is undermined by defining the term in this manner. Having adopted an "urban referral center" definition which may not be met by any hospital, HHS has compounded its undermining of Congressional intent by failing to propose any adjustment or exception for qualifying referral centers. Under the law, the adjustment should reflect the special needs of referral centers.

In the September 1 regulation, HHS reports they have not found a relationship between a hospital's Medicaid utilization and its average cost per Medicare case. In making this assertion, HHS provides no information which may be used by an independent observer to conclude that there is no relationship between the income status of a hospital's patients and the hospital's cost per case. Moreover, the statute provides authority to adjust payments for a hospital's special needs, not simply its Medicare cost per case. The fulfill the Congressional expectation, the adjustment for low income patients should not be limited to the proportion of patients supported by Medicaid, a program whose eligibility criteria vary by state. The Medicare program should determine low income status using a consistent definition (possibly adjusted for variations in the cost of living in specific areas) or criteria reflecting a hospital's bad debts and charity care.

To qualify as a cancer hospital, 80 percent of the hospital's total discharges must be classified in the cancer DRGs. Given the construction of the DRGs, this requirement means 80 percent of all of the hospital's patients must have cancer as a principal diagnosis. Because some patients are admitted to cancer hospitals due to the fact that cancer complicates their treatment for another disease, the hospital's total discharges must have cancer as a primary or secondary diagnosis.

The adjustment allowed for cancer hospitals is limited to those designated as comprehensive cancer centers or clinical cancer research centers by NIH as of April 20, 1983. the rationale for limiting the adjustment to hospitals recognized in this manner by NIH prior to April 20 is weak and not consistent with apparent Congressional intent.

We are currently working to develop criteria which will identify the hospitals that should qualify for these three provisions. These proposed criteria will be submitted with our comments on the proposed regulations. However, I strongly recommend that you monitor DHHS's regulations to ensure that the provisions for defining and making adjustments to the payment rates for cancer hospitals, national and regional referral centers, and hospitals serving disproportionate numbers of low income patients reflect Congressional intent. Since this is the second time that DHHS has been instructed by Congress to make an adjustment of hospitals serving disproportionate numbers of poor people (the first time was in TEFRA), and the second time that no such adjustment was made, your Committee may wish to closely examine DHHS's rationale. In particular, you may wish to request copies of the studies which led the Department to the conclusion that the presence of such patients didn't make a difference.

Statement of the Blue Cross and Blue Shield Association

On behalf of the Blue Cross and Blue Shield Association, the national coordinating agency of 99 Blue Cross and Blue Shield Plans, we would like to thank the Committee on Ways and Means for the opportunity to comment on H.R. 3805, "The Technical Correction Act of 1983." H.R. 3805 is intended to clarify and conform various provisions of recent tax, social security and related legislation. We support the Committee's efforts to refine these important pieces of legislation and wish to take this opportunity to suggest other technical amendments to the legislation affected by the bill.

Our comments concern two provisions of the "Tax Equity and Fiscal Responsibility Act of 1982" (TEFRA): Section 116 of TEFRA which made Medicare payments secondary for older workers covered under group health plans (known as the "working aged" provision); and section 143 of TEFRA which established the requirements concerning contracts with Utilization and Quality Control Peer Review Organizations (PROs).

WORKING AGED

We strongly support Section 412 of H.R. 3805, which would eliminate any penalty for late enrollment in Medicare Part B for persons age 65 through 69 who are cov-

ered by an employer group health plan which is the primary payor. This provision would correct a significant discrepancy detrimental to many Medicare beneficiaries.

In addition, we recommend that Congress consider correcting another discrepancy in the "working aged" provisions which creates administrative problems, and has the potential to adversely affect beneficiaries. Specifically, we recommend elimination of the existing inconsistency between the Medicare law and the Age Discrimination in Employment Act (ADEA) regarding the date on which an individual reaches age 70, and thus is no longer subject to the "working aged" provisions. Although the ADEA amendment contained in the TEFRA "working aged" provision is silent on this issue, implementing regulations published by the Equal Employment Opportunity Commission (EEOC) specify that the individual must be covered by the employer's health plan through the *day* he or she reaches age 70. The EEOC has indicated that this interpretation is required by the specific age limitations set forth in the ADEA. On the other hand, the Medicare "working aged" provisions specify that Medicare does not become primary payor for the individual until the end of the month in which the individual reaches age 70, thus potentially depriving the beneficiary of coverage in the interim. We believe this discrepancy was not intended and recommend that Congress amend the ADEA to conform to the Medicare law for purposes of the "working aged" requirements. For ease of administration we recommend the adoption of the Medicare definition which ties the date of eligibility to a month, rather than a day.

PEER REVIEW ORGANIZATIONS PRO'S

We recommend that Congress clarify the prohibition contained in section 1153(b)(3) of the Social Security Act, added by section 143 of TEFRA, against entering into a PRO contract with an organization that is "affiliated with (through management, ownership or common control), a health care facility, or association of such facilities." Under current law, payor entities, such as Blue Cross and Blue Shield Plans, may compete for PRO contracts beginning in October 1984. However, the regulations published by the Health Care Financing Administration's (HCFA) on August 15, 1983 include an overly broad interpretation of "affiliation" which, if allowed to stand, would preclude most Blue Cross and Blue Shield Plans from ever having the oppoutunity to compete as PROs. We believe this result was not intended by Congress.

The proposed HCFA regulations would define "affiliation" in such a way as to deny PRO eligibility to any organization that "has a governing body member, officer, partner, 5 percent or more owner, or managing employee who is also governing body, member, officer, partner, 5 percent or more owner or managing employee in a PRO area health care facility or association of health care facilities."

Most Blue Cross and Blue Shield Plans are governed by boards that include some hospital trustees and/or administrators. The boards of many Plans also may include physicans who practice in local health facilities. These individuals typically constitute such a small fraction of the Plan board that, even if thay acted in concert, they could not possibly exercise powers of ownership, management, or control over the board as a whole or the Plan. However, under HCFA's proposed rule Blue Cross and Blue Shield Plans would be ineligible to compete as the potential PRO in their respective states because of this representation, even though in some cases provider representation on Plan boards is required by state law.

We strongly support the intent of the law and HCFA's objective to prevent conflicts of interest which could compromise or appear to compromise the integrity of the review process. However, unbiased medical and utilization review can be achieved with conflict of interest language that is much less sweeping than that proposed under the regulation.

Given the importance of this issue to the success or failure of the PRO program, we recommend that it not be left solely to the administrative discretion of the Secretary of Health and Human Services. We recommend that the law be amended to clarify congressional intent. One approach that could be adopted would be to define "affiliated" in a manner similar to that used in the Medicare regulations concerning reimbursement of costs for services supplied to a provider by a related organization. These regulation (405.427) define a related organization as follows:

"Related to the provider means that the provider to a significant extent is associated or affiliated with or has control of or is controlled by the organization furnishing the services, facilities, or supplies."

The terms, "significant association" and "control," used in this definition describe a strong connection between two organizations. By contrast, two corporations having a single governing body member in common cannot reasonably be viewed as

"affiliated" in the same light, or in any sence that would suggest influence of one over the over that could bias PRO review.

We would be happy to assist the Subcommittee in any way possible as you consider these technical amendments.

CAPLIN & DRYSDALE,
Washington, D.C., September 28, 1983.

JOHN J. SALMON,
Chief Counsel, Committee on Ways and Means,
Washington, D.C.

DEAR JOHN: This letter presents written comments on H.R. 3805 for inclusion in the record. It explains the need for clarification and simplification of sections 324(c) and (d) of the Social Security Amendments of 1983 (SSA), as modified by section 402(f)(2)(A) of the proposed Technical Corrections Act of 1983 (TCA). In essence, we recommend deleting section 402(f)(2)(A) from the TCA, but adding a discussion of the phrases "agreement in existence March 24, 1983" and "substantial risk of forfeiture" as they appear in sections 324(c) and (d) of the SSA to the committee reports on the TCA.

BACKGROUND

Section 324(c)(1) of the SSA amended section 209 of the Social Security Act to include employer contributions under a qualified cash or deferred compensation plan and amounts deferred under a nonqualified deferred compensation plan in the FICA wage base. Under section 324(d)(1), this amendment applies to all remuneration paid after December 31, 1983, without regard to when the services were performed or the compensation deferred, except for compensation which falls within the scope of the grandfathering provisions of section 324(d)(4). That section provides that, in the case of an agreement in existence on March 24, 1983, between a nonqualified deferred compensation plan and an individual, only compensation for services rendered after December 31, 1983, is included in the FICA wage base.[1] All deferred compensation paid after December 31, 1983, which is not grandfathered under section 324(d)(4), is to be taken into account in the later of the year the services are performed or when the employee's right to such amount is no longer subject to a substantial risk of forfeiture. Section 324(c)(1).

Section 402(f)(2)(A) of the TCA would add a special rule to section 324(d)(1) of the SSA which would require that:

"For purposes of applying such amendments to remuneration paid after December 31, 1983, which would have been taken into account before January 1, 1984, if such amendments had applied to periods before January 1, 1984, such remuneration shall be taken into account when paid."

The effect of sections 324(c)(1), 324(d)(1) and 324(d)(4) of the SSA and section 402(f)(2)(A) of the TCA taken together would appear to be as follows: where benefits paid after December 31, 1983, are deferred under a plan that was not in existence on March 24, 1983, and are thus not grandfathered under 324(d)(4), they are taxable upon the later of the date the right to such benefits is no longer subject to a substantial risk of forfeiture and the date the services for which the benefits are paid were rendered. However, where such non-grandfathered benefits, although paid after December 31, 1983, are no longer subject to a substantial risk of forfeiture prior to that date and represent payment for services rendered prior to that date, they fall within the scope of the special rule of the TCA which would require that they be subject to FICA taxes in the year paid.

PROPOSED CHANGES

The scheme described above needs to be clarified in three respects, and is rendered unnecessarily complex by the special rule proposed in the TCA. These flaws are perhaps best illustrated in the context of a specific example: Corporation X maintains a nonqualified unfunded supplemental retirement plan, extant on March 24, 1983, under which participants receive annual retirement benefits equal to two percent of average final three years' pay for each year of service, minus Social Security benefits and the pension provided under Corporation X's qualified retirement plan. An employee's right to the annuity vests at age 60, but payments do not commence until retirement, which normally occurs at age 65, and all benefits cease upon the employee's death. The plan was amended in June of 1983 to change the

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[1] The rules for inclusion in the FUTA wage base are generally the same, except that they are effective 1 year later.

investment and alternative payment options, but without any change in the value of benefits provided under the plan. The plan was amended again in September 1983 to increase the benefits for retirees, as well as active participants, from two percent to two and one-half percent of final average three years' pay for each year of service. Consideration of the year in which benefits deferred under this plan are to be taken into account in the FICA wage base of the participants in the plan underscores four deficiencies in the current statutory scheme.

In attemping to comply with the provisions of section 324, the employer in the hypothetical case would need first to isolate those benefits which are grandfathered under section 324(d)(4). In the absence of the June and September amendments to the plan, benefits for services rendered prior to December 31, 1983, would certainly be grandfathered under section 324(d)(4), for the plan was in existence March 24, 1983. Unfortunately, section 324(d)(4) provides no guidance as to whether either the June or September amendments affect the plan's status as an "agreement in existence March 24, 1983," for purposes of the grandfathering provisions.

It seems reasonable to assume that where a plan in existence since March 24, 1983, is amended subsequent to that date in a manner that has no effect on the level of benefits provided under the plan, Congress intended that all benefits deferred under the plan for services rendered prior to December 31, 1983, are to receive the benefit of the grandfathering provisions of section 324(d)(4). Similarly, Congress presumably intended that where a plan amendment alters the level of benefits provided under a plan, those benefits deferred under the plan as it existed on March 24, 1983, for services rendered prior to December 31, 1983, would still be grandfathered under section 324(d)(4). The reasonableness of these assumptions in borne out by the fact that the contrary interpretation of section 324(d)(4) would render the statutory scheme exceedingly awkward and complex; the status of all benefits deferred under a plan as it existed March 24, 1983, for services rendered prior to December 31, 1983, would remain forever uncertain, since an amendment to the plan, even ten or twenty years hence, would transform what were previously grandfathered benefits into non-grandfathered benefits.

Thus, in order to confirm what must have been the legislative intent in enacting section 324(d)(4), an explanation of the effect of amendments on a plan's status as an "agreement in existence March 24, 1983," should be included in the TCA committee reports. The explanation might present the hypothetical set forth above, accompanied by the conclusion that deferred compensation equal to two percent of the participant's average final three years' pay for each year of service rendered before December 31, 1983, would be grandfathered under section 324(d)(4). The additional one-half percent for services rendered prior to December 31, 1983, attributable to the September amendment would not be so grandfathered.

After isolating those benefits grandfathered under the plan, Corporation X in the hypothetical case must determine at what point non-grandfathered benefits are to be taken into account. To do this the empoloyer must engage in a two-step analysis: The employer must first determine when non-grandfathered benefits would (absent the TCA) be taken into account under the standard imposed by section 324(c)(1), viz., the later of the date services are rendered or the date no substantial risk of forfeiture of the right to the amount in question exists. Those amounts which would be taken into account prior to December 31, 1983, would fall within the scope of the special rule of the TCA and must be taken into account by the employer when paid to the participant.

The first stumbling block encountered by the employer in attempting to follow this analysis, however, is the question of whether, in the case of an employee who is otherwise fully vested and who chooses an annuity payout, death constitutes a substantial risk of forfeiture after a participant has entered pay status. Although the Conference Report provides that the phrase "substantial risk of forefeiture" possesses the same meaning as that attributed to it under section 83 of the Code (Conference Report No. 98-47, 98th Cong., 1st Sess., p. 147 (March 24, 1983)), the law as developed under section 83 provides no clear resolution of this issue.

The correct answer to this question would seem to be that death is not a substantial risk of foreiture. This view coincides with the very definition of the employee's rights under the plan, and with what it means to receive an annuity. Upon his retirement each participant who elects an annuity receives a nonforfeitable right to annual benefits until his death. By definition, he cannot be said to have forfeited that right simply because his annuity benefits cease upon his death. Part of what it means to receive annuity payments is to be insured against old age, and no forfeiture is involved simply because payments cease at death. Moreover, the right to receive annuity payments has a known and easily determined value, since a contract to provide a participant such benefits could be purchased from any commercial in-

surance company for a fixed sum at the date of his retirement. In order to clarify this point and prevent needless controversy, we recommend that the TCA committee reports spell out that death does not constitute a substantial risk of forefeiture after a participant has begun to receive annuity payments under a plan.

The employer's next dilemma arises in applying the "substantial risk of forfeiture test" of section 324(c)(1) to the incremental benefits attributable to the September 1983 amendment for services rendered before 1984 by participants whose rights become fully vested before 1984. Common sense suggests that even participants who become fully vested under the plan prior to 1983 cannot be said to have been entitled to the incremental benefits until 1983, the year the amendment came into existence, and therefore amounts attributable to the September amendment should not be taken into account prior to 1983 even though they represent retroactive benefit increases for employees who previously became fully vested. It is not entirely clear, however, how to treat this problem under the standard of section 324(c)(1). Probably the most logical rationale is to treat benefits that have not yet come into existence as being "subject to a substantial risk of forfeiture." Alternatively, section 324(c)(1) could be read to require that deferred compensation be taken into account at the latest of three dates: (i) the date tht services are performed, (ii) the date there is no substantial risk of forfeiture of the right to that amount, or (iii) the date the right comes into existence. If either of these interpretations is applied to the hypothetical example, the incremental benefits with respect to services previously rendered by participants whose rights vested prior to December 31, 1983, would be taken into account in 1983. Thus, those benefits fall within the scope of the special rule of the TCA and would to be taken into account in the year paid.

Although the committee reports on the TCA should adopt one or other of these interpretations, so that there will be guidance on how to handle the numerous instances in which deferred compensation plans will be amended (either in 1983 or at any later time), the result in this particular hypothetical case illustrates the needless complexity added by the special rule of the TCA: benefits deferred on behalf of these participants in our hypothetical who vest prior to December 31, 1983, will be subject to three different rules. Those benefits deferred under the plan as it existed on March 24, 1983, for services rendered prior to December 31, 1983, are grandfathered under section 324(d)(4); incremental benefits attributable to the amendment of September 1983 and deferred for services rendered prior to December 31, 1983, will be taken into account when paid under the special rule; and all benefits deferred for services rendered after December 31, 1983, will be taken into account on the date services are rendered.

The use of the three rules creates unwieldy allocation problems for employers and is completely unnecessary. Contrary to the explanation of H.R. 3805 prepared by the staff of the Joint Committee and dated September 15, 1983, there is no ambiguity as to the treatment of non-grandfathered benefits paid after December 31, 1983, for services performed prior to December 31, 1983, and for which there was no substantial risk of forfeiture at some time prior to that date. Section 324(d)(1) explicitly provides, without exception, that all non-grandfathered benefits paid after December 31, 1983, are to be taken into account under the existing rules of section 324(c)(1). Thus, absent the special rule, none of the non-grandfathered benefits—whether for services before 1984 or after 1983—would be inadvertently excluded from the employee's FICA wage base. Moreover, even if any uncertaintly on this point existed, it would be adequate to include in the committee reports to the TCA an explanation that all deferred compensation not grandfathered under section 324(d)(4) is subject to the new rule of section 324(c)(1), regardless of when the services were rendered or when the benefits were no longer subject to a substantial risk of forfeiture. Thus, in the interest of simplifying the administration of the withholding provisions, the special rule should be deleted from the TCA.

If you need further information or if we can be of any additional assistance on this matter, please do not hesitate to contact us.

Sincerely,

L. E. IRISH.

CAPLIN & DRYSDALE,
Washington, D.C., September 28, 1983.

JOHN J. SALMON,
Chief Counsel, Committee on Ways and Means,
Washington, D.C.

DEAR JOHN: This letter constitutes our written statement on section 103(a)(2) of H.R. 3805. the proposed Technical Corrections Act of 1983. It explains the need for an amendment to the transitional rules governing the new section 415 limitations imposed by the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA") on the annual benefits that may be provided under a collectively bargained defined benefit plan.

The clarifying amendment proposed in this letter, when added to section 103(a)(2) of H.R. 3805, "The Technical Corrections Act of 1983," (the "TCA") would ensure that, in the case of a collectively bargained plan, benefits that satisfy pre-TEFRA limits and that have been accrued for a participant as of the date the new TEFRA limitations become applicable are grandfathered on a parity with benefits accrued for participants in other plans. The terms of the amendment and the reason for it are best understood after a brief recitation of the transitional rules currently in force under TEFRA.

Section 235(a) of TEFRA amended Code section 415 to reduce the maximum annual benefit a defined benefit plan may provide a participant from $136,425 to $90,000. In the case of plans in existence on July 1, 1982, other than collectively bargained plans, the new limitation becomes applicable January 1, 1983. TEFRA § 235(g) (1)(B). In order to grandfather pre-TEFRA accrued benefits, section 235(g)(4) provides that, if the current accrued benefit of a participant in January 1, 1983, that accrued benefit, rather than the new $90,000 TEFRA limit, becomes the new section 415 limitation. For purposes of determining a participant's current accrued benefit under this transition rule as of January 1, 1983, changes in the terms and conditions of the plan after July 1, 1982, and cost-of-living adjustments occurring after July 1, 1982, are taken into account. TEFRA § 235(g)(4)(B)(ii).

TEFRA also contains a special transition rule which delays the application of the new limit to collectively bargained plans. Under section 235(g)(5), in the case of a defined benefit plan in existence on the date of the enactment of TEFRA and maintained pursuant to one or more collective bargaining agreements, the new limits does not apply until the last of the collective bargaining agreements relating to the plan terminates, or until January 1, 1986, whichever occurs earlier. However, Congress failed to include a provision clarifying its evident intention that benefits accrued under a collectively bargained plan prior to the effective date of the section 415 limits imposed by TEFRA are to be grandfathered under section 235(g)(4).

Section 103(a)(2) of the TCA would remedy this problem by modifying section 235(g)(4)(B)(i) to spell out that in the case of a participant in a collectively bargained plan in existence as of July 1, 1982, if the participant's current accrued benefit as of when the TEFRA limits became applicable exceeds that limit, the participant's current accrued benefit would become the secton 415 limit. As proposed, however, the TCA makes no change in section 235(g)(4)(B)(ii). Thus, under determining a participant's current accrued benefit as of the relevant date, changes in the terms and conditions of the plan after July 1, 1982, and cost-of-living adjustments occurring after July 1, 1982, would not be taken into account.

This approach creates a unique problem for participants in a number of collectively bargained plans. Where changes in such a plan were made pursuant to a collective bargaining agreement negotiated and signed by representatives of the employer and the union prior to July 1, 1982, but were not ratified by the board of directors of the employer and the membership of the union until after July 1, 1982, the changes would not be taken into account in determining a participant's current accrued benefit under the transitional rules. In other words, simply because it often takes 30 to 60 days or longer to complete the ratification procedures for union-negotiated plans, benefits properly accrued under the old section 415 limits under a plan the amendments to which had been agreed to by the union and the employer prior to July 1, 1982, would not be grandfathered even where the changes were ratified prior to the enactment of TEFRA, September 3, 1982. In essence, participants in a collectively bargain plan are penalized vis-a-vis participants in other types of plans owing to the more cumbersome mechanisms frequently necessary to effect a change in a collectively bargained plan.

In order to alleviate this hardship, and to conform the statute to what surely was the Congressional intention, we suggest that a provision be added to the TCA which would amend section 235(g)(4)(B)(ii) of TEFRA by striking the period at the end of the sentence and inserting, "except, in the case of a plan described in paragraph (5),

changes in the term and conditions of the plan made pursuant to one or more collective bargaining agreements reached prior to July 1, 1982, and ratified prior to September 3, 1982."

This new provision, when combined with section 103(a)(2) of the TCA, would ensure that, where changes in the terms of a collectively bargained plan had been agreed to by management and labor prior to July 1, 1982, benefits attributable to the changes would be grandfathered under the TEFRA transitional rules, so long as all formalities necessary to finalize the changes had been satisfied by the date of TEFRA's enactment.

If you have any questions regarding this matter, or would like further information or analysis, please do not hesitate to call me.

Very truly yours,

L. E. IRISH.

STATEMENT OF GENWAY CORP.

INTRODUCTION

Genway Corporation is engaged in the motor vehicle leasing business on a national scale. Genway's vehicle leases contain provisions that we believe should be treated as terminal rental adjustment clauses for purposes of Section 210 of TEFRA. We also believe that this should be clarified as a technical correction to TEFRA.

Description of the Genway Corp. lease

Genway Corporation is engaged in the business of purchasing automobiles which it then leases to automobile dealers for use in their business, the business of subleasing the automobiles to the ultimate users of the automobiles. The leasing and financing of the automobiles are governed by "qualified motor vehicle agreements" within the meaning of Section 210 (b)(1) of TEFRA.

When an automobile lease terminates, the lessee-dealer is required by the lease agreement to purchase the automobile from Genway Corporation for a specified value determined under a formula in the agreement. The lessee-dealer must purchase the automobile exclusively for resale and not for use in its vehicle leasing business.

Substantive identity of Genway Corp. lease clause and other terminal rental adjustment clauses

The essence of a terminal rental adjustment clause is that it places the economic risk of resale of a leased motor vehicle on the lessee of the vehicle. This is commonly accomplished by comparing the amount realized on the sale of the vehicle at lease termination to a value that was predetermined at lease inception. The difference is charged or credited to the account of the lessee at lease termination. Typically, the lessor is an automobile dealer or has facilities to sell used vehicles.

On the other hand, in the case of Genway Corporation, the lessee—not the lessor—is a dealer in automobiles with facilities to sell used vehicles. It therefore makes sense to have the lessee sell the vehicle. The terminal rental adjustment is accomplished by having the lessee sell the vehicle (as required in the lease agreement) and keep the proceeds; however, the lessee must pay Genway Corporation the value that was pre-determined at lease inception. Thus, the lessee has the economic risk of resale. This end result is identical in substance to a terminal rental adjustment clause which provides that the lessee bears the burden of economic gain or loss.

CONCLUSION

Because the economic results under the terminal rental adjustment clause under the Genway Corporation lease are identical in substance to those under the type of clause specifically described in Section 210 of TEFRA, we believe that both types of clauses should be encompassed by the relief provided under Section 210 of TEFRA. We further believe that to reach a contrary result would ignore the substance of the transaction—a rental adjustment to the leasee based on the amount realized on resale of the vehicle. This should be made clear in a technical correction to TEFRA.

STATEMENT OF F. CLEVELAND HEDRICK, JR., WILKES, ARTIS, HEDRICK & LANE, WASHINGTON, D.C.

The undersigned is a former General Counsel of the Federal Excise Tax Council and an attorney with the Washington law firm of Wilkes, Artis, Hedrick & Lane, Chartered.

I would like to take this opportunity to urge this Committee to incorporate the provisions of H.R. 3998, introduced by Rep. Guy Vander Jagt of Michigan, into the Technical Corrections Act of 1983. H.R. 3998 would make technical amendments to the excise tax credit provisions that are made necessary by recent actions of the Internal Revenue Service.

The IRS. for the first time since the 1970 enactment of the technical amendment [1] upon which its position is based, has issued a hyper-technical interpretation (Rev. Rul. 82-14, 1982-1 C.B. 21) which has the effect of imposing an unintended double excise tax on truck parts and accessories. The new interpretation would be applied retroactively by the IRS to 1970 despite the fact that the 1970 technical amendments had the stated intention to effect a result under with ". . . no item (would be) included in the tax base more than once." S. REP. No. 91-1444, 91st Cong., 2d Sess., 23 (1970).

Although the Highway Revenue Act of 1982 repealed the manufacturer's excise tax, many tax periods of manufacturers that were subject to the tax remain open for IRS audits. Furthermore, truck parts sold prior to the repeal of the manufacturers tax are potentially includible in the base for computing the new heavy truck retail tax under Code section 4051, as added by the Highway Revenue Act.

Rev. Rul. 82-14 denies a refund or credit to a truck parts manufacturer who has erroneously paid manufacturer's excise tax on its sales to distributors where the distributor resells the parts tax-free to others for further manufacture. such sales by the manufacturer were exempt from the manufacturer's excise tax (prior to its repeal) under § 4221 of the IRC if the distributor provided evidence that the part was indeed resold for further manufacture. The applicable excise tax was later paid by the subsequent manufacturer upon its sale of the truck which includes the part.[2] If the original manufacturer, who paid the excise tax on its sale to the distributor, is barred from taking a credit for this tax it erroneously paid, the IRS collects on unauthorized double tax based on a procedural technicality.

As a precaution against underpayment of the tax, some parts manufacturers reported all sales to distributors as taxable sales on their quarterly excise tax returns, paid the tax on their total sales and billed the distributors for the tax-included price. When the distributor resold the parts tax-free to subsequent manufacturers for incorporation in a truck it submitted to the original manufacturer the evidence required by IRS regulations to qualify the initial sale as exempt, and the original manufacturer issued the distributor a credit for the tax. In turn the manufacturer took a credit on its next quarterly federal excise tax return for the tax erroneously paid.

In Rev. Rul. 82-14 the IRS takes the position that the original manufacutrer is not entitled to any credit or refund for the tax it erroneously paid in this situation. The ruling holds that any credit or refund may only be claimed by the subsequent manufacturer. However, the subsequent manufacturer never claims credit or refund because it paid no tax to the distributor as part of its purchase price. When the subsequent manufacturer sells its truck, the applicable tax is paid a second time on the part sold by the original manufacturer.

The 1970 technical amendments (Section 302, P.L. 91-614) were undoubtedly intended to give the subsequent manufacturer the right to the credit (to the exclusion of the original manufacturer) only in situations where the subsequent manfacturer had paid a tax-included price to the distributor and not in situations where it had purchased them tax-free. However, because the 1970 technical and conforming amendments are somewhat ambiguous and inartfully drawn, the IRS has a tenuous technical basis for making the interpretation included in Rev. Rul. 82-14. Litigation will undoubtedly result if this situation is not corrected.

The IRS is now applying its inequitable double taxation position in its audit of years prior to the date of its ruling. The background file to Rev. Rul. 82-14 indicates that the IRS recognizes that a double tax windfall may result from its holding.

H.R. 3998 would make it clear that the original manufacturer in the situation described would be entitled to a credit or refund. It is necessary to prevent an unfair

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[1] Sec. 302(b), Public Law 91-614.

[2] Under the Highway Revenue Act, parts incorporated into certain heavy trucks and trailers are subject to the retail excise tax rather than the manufacturer's tax.

double tax, unauthorized by Congress, at the expense of manufacutrers who attempted to ensure that the correct amount of excise taxes due were indeed paid.

I urge this Committee to consider this technical amendment and enact it as part of the Technical Corrections Act of 1983.

Statement of Samuel W. Anderson, Executive Director, the Teachers' Retirement System of the State of Illinois

On behalf of the 170,000 members of the Illinois Teachers' Retirement System, I welcome the opportunity to express an opinion on House Resolution 3805. The specific language offered in House Resolution 3805 does not fully address the problems created by the existing statutory language.

The Tax Equity and Fiscal Responsibility Act of 1982 amended Code Section 401(a)(9) to require the entire remaining interest of a deceased employee to be paid within a five year period if a nonspousal individual were the beneficiary. Under Illinois Statute, beneficiaries of a deceased teacher eligible for a monthly benefit may be a spouse; an unmarried child under the age of 18, or a parent who was receiving at least one-half of his or her support from a System member for the 12 month period prior to the member's death. Illinois Statute permits payment of these benefits for each class of individuals for periods in excess of five years.

Any requirement within the Internal Revenue Code to reduce the length of time eligible beneficiaries may receive benefits would be in direct conflict with Illinois State Statute as well as the Illinois State Constitution which specifically prohibits any diminishment of benefits from a State pension fund.

The amendatory language of House Resolution 3805 provides some relief from the 401(a)(9) provision by permitting distributions beyond five years for children, provided they are under age 22, or permanently and totally disabled. However, the suggested language of House Resolution 3805 does not address the five year limitation for beneficiaries who are deemed to be dependent parents. I urge the Committee to modify Code Section 401(a)(9) to exempt public pension plans or, additionally, exempt dependent parents from the five year limitation.

Statement by the Municipal Finance Officers Association

The Municipal Finance Officers Association (MFOA) represents 9,200 members who are state and local government finance officials, appointive or elective, and public finance specialists. Included in the MFOA membership are public employee retirement system administrators who are responsible for the day-to-day operation and supervision of public pension plans.

The Municipal Finance Officers Association supports the steps taken in H.R. 3805, the Technical Corrections Act of 1983, to amend Section 401(a)(9)(B) of the Internal Revenue Code. However, we believe this legislative remedy only goes part of the way in correcting the requirement in the Tax Equity and Fiscal Responsibility Act of 1982, (TEFRA) that a pension plan, if it wishes to maintain tax-qualified status, generally must distribute the entire value of a non-spousal annuity within a five-year period. Accordingly, we are calling on Congress to fully exempt public plans from the provisions enacted in TEFRA pertaining to payouts.

The Technical Corrections Act would exempt two specific classifications of beneficiaries from the payout limitations: Dependent children up to age 22, and disabled dependents for a term not exceeding their life expectancy.

Although these amendments will reduce the disruption the five-year payout will cause state and local public employee retirement systems, they do not give adequate relief for the following reasons: The maximum age for a full-time student benefits is set at 23 by many plans; the life expectancy of a disabled individual will be difficult to ascertain; and the effective date does not provide ample time to make state law and constitutional amendments.

The MFOA takes the position that state and local plans should not be required to comply with the five-year rule. (See attached policy). State and local plans have legitimate reasons, not based on tax-sheltering objective, to offer their participants a choice of beneficiaries who should share in extended retirement benefits such as a sibling or dependent parent. the majority of state and local employees are covered by the Social Security System. However, for the dependents of uncovered workers, making up approximately 25% of the state and local employees, the annuity paid from the public employee retirement system is the only retirement payment received. This provision would leave those groups of dependents not exempted under H.R. 3805 without regular income after a five-year period.

The original TEFRA provision was aimed at establishing parity between KEOUGH and corporate pension plans in the distribution and taxation of benefits. The logic of extending the same treatment to public plans is questionable. Public employers being tax-exempt entities are not motivated to design plans that provide tax-sheltered benefits. Furthermore, the reduction of the estate tax exclusion to $100,000 diminishes the participant's incentive to pass annuity payments to future generations because the opportunity to avoid taxation is removed.

State laws and constitutional provisions dictate the level and delivery of benefits to employees. These provisions are binding and many states and localities are prohibited from diminishing the benefits of active plan participants unless legislative amendments are enacted. Both TEFRA and H.R. 3805 will require the majority of states to amend their governing laws or jeopardize thier tax qualification. The National Council on Teachers Retirement conducted a survey of state laws governing distribution of survivor benefits and found that approximately 80% of the states will have to make changes in state law and several (including New York, Illinois and Michigan) must approve constitutional amendments in order to comply with the payout limitations.

The value of this federal preemption of state laws should be reexamined as the federal revenue raised by limiting the benefit payout period is negligible. The dislocation the non-spousal payout restrictions will cause at the state and local level seem to far outweight the benefit to the federal government. States and localities not only have to request state ligislatures to amend statutes, and in some cases constitutions, but they will have to bear the administrative cost of revising plan brochures, documents and computer programs. The time allowed in TEFRA and H.R. 3805 to accomplish these legislative changes is insufficient as some state legislatures only meet on a biennial schedule and will not be in session in 1984. (See attached legislative calendar).

TEFRA also mandated another new requirement for pension plans, that of withholding of income taxes from qualified distributions. The pension community as a whole, including the public pension systems, has complied with this procedure. The MFOA was instrumental in providing technical assistance to state and local public employee retirement systems in preparing to withhold taxes and worked as a liaison between the IRS and public plans to accomplish successful implementation of regulations. There was no repeal movement against this pension withholding mandate. We cooperated because there was a discernable federal revenue benefit. However, no such benefit has been demonstrated by the national government in enacting the payout limitation rule.

The Municipal Finance Officers Association takes the position that state and local employee retirement systems should be exempted from IRC Section (401)(a)(9)(B) because: This provision preempts state laws and constitutions while providing no measurable revenue to the federal governments; and This provision was aimed at stopping an nonexisting abuse in the public sector. This misconception on the part of federal lawmakers results in increased and unnecessary human and financial costs for state and local governments.

MUNICIPAL FINANCE OFFICERS ASSOCIATION POLICY STATEMENT

Five-year payout of certain beneficiary benefits

Section 242 of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) amended Section 401(a)(9)(B) of the Internal Revenue Code to require that, when a qualified pension plan participant dies leaving a beneficiary other than a spouse, the entire value of any annuity provided by the plan must be paid out within five years.

Generally, state law mandates public employee pension plans to provide payment of a survivor's annuity upon the death of an employee while in active service. While these benefits are normally payable to the surviving spouse, they are frequently paid to a child or children. Thus, due to the occurence of a divorce or a common catastrophe, survivor benefits are often paid to minor children for periods greatly exceeding five years. In addition, a member or retiree may want to name a beneficiary, where such option exists other than the spouse for reasons unrelated to tax considerations.

Furthermore, it is difficult to determine the present value of a minor child's benefit. There are several circumstances where benefits could be curtailed, such as an adoption, or prolonged in the case of a fulltime or handicapped dependent.

Moreover, death benefits are not generally considered part of the decedent's estate as they are payable either by law or designation to a specified individual. Therefore, these payments are not subject to the control of the probate courts.

This section of the Internal Revenue Code was designed to significantly limit the estate planning uses of corporate pension plans. However, there has been an unintended effect on state and local pension plans.

The MFOA believes that there are valid public policy reasons to permit public employee retirement system beneficiaries other than spouses to continue to receive the full range of retirement and death benefits beyond the five-year period following the death of a retiree or member.

During its consideration of a TEFRA technical corrections bill the United States Congress should be advised of the conflict caused by Section 401(a)(9)(B) between federal tax law and state and local mandates and constitutional provisions. Therefore, the non-spousal beneficiary benefits provided by public employee retirement systems should be completely and clearly excluded from the five-year payout requirement—adopted, June 14, 1983.

NATIONAL CONFERENCE OF STATE LEGISLATURES, 1983 SESSION CALENDAR

State	Dates	Limits
Alabama	Apr. 19–Aug. 1	30 legislative in 105 calendar days.
Alaska	Jan. 17–May	No limit.
Arizona	Jan. 10–late April	April 15.
Arkansas	Jan. 10–Mar. 10	60 calendar days.
California	Dec. 6 (1982)–mid-September	No limit.
Colorado	Jan. 5–early June	No limit.
Connecticut	Jan. 5–June 8	June 8.
Delaware	Jan. 11–June 30	June 30.
Florida	Apr. 5–June 3	60 calendar days.
Georgia	Jan. 10–late March	40 legislative days.
Hawaii	Jan. 18–mid-April	60 legislative days.
Idaho	Jan. 10–late March	No limit.
Illinois	Jan. 12–June 30 (fall veto session)	Do.
Indiana	Jan. 10–late April	61 legislative days or Apr. 30.
Iowa	Jan. 10–mid-May	No limit.[1]
Kansas	Jan. 10–early May	Do.
Kentucky	No session	
Louisiana	April 18–July 11	60 legislative in 85 calendar days.
Maine	Dec. 1–May	No limit.
Maryland	Jan. 12–Apr. 11	90 calendar days.
Massachusetts	Jan. 5–all year	No limit.
Michigan	Jan. 5–all year	Do.
Minnesota	Jan. 4–May 23	120 legislative days or 1st month after 3d Saturday in May.
Mississippi	Jan. 4–Apr. 3	90 calendar days.
Missouri	Jan. 5–June 30	June 30.
Montana	Jan. 3–late April	90 legislative days.
Nebraska	Jan. 5–mid-May	Do.
Nevada	Jan. 17–May	No limit.[1]
New Hampshire	Jan. 5–June	No limit.[1]
New Jersey	Jan. 11–all year	No limit.
New Mexico	Jan. 18–Mar. 18	60 calendar days.
New York	Jan. 5–all year	No limit.
North Carolina	Jan. 12–June	Do.
North Dakota	Jan. 4–late March	80 legislative days.
Ohio	Jan. 3–all year	No limit.
Oklahoma	Jan. 4–June	90 legislative days.
Oregon	Jan. 10–July	No limit.
Pennsylvania	Jan. 4–all year	Do.
Rhode Island	Jan. 4–May	No limit.[1]
South Carolina	Jan. 11–June	No limit.
South Dakota	Jan. 4–early March	40 legislative days.
Tennessee	Jan. 4–May	90 legislative days.[1]
Texas	Jan. 11–May 30	140 calendar days.
Utah	Jan. 10–Mar. 10	60 calendar days.
Vermont	Jan. 5–late April	No limit.
Virginia	Jan. 12–mid-February	30 calendar days.
Washington	Jan. 19–Apr. 24	105 calendar days.

NATIONAL CONFERENCE OF STATE LEGISLATURES, 1983 SESSION CALENDAR—Continued

State	Dates	Limits
West Virginia	Jan. 12–Mar. 12	60 calendar days.
Wisconsin	Jan. 11–late June (fall session probable)	No limit.
Wyoming	Jan. 11–Feb. 25	40 legislative days.

[1] Limit on number of days for which legislators may be paid or receive per diem. Organizational Sessions: Alabama, Jan. 11, Florida, Nov. 16, Indiana, Nov. 16, New Hampshire, Dec. 1, North Dakota, Dec. 7, South Carolina-mid-November (House only), Tennessee, Jan. 4.

TABLE 15.—LEGISLATIVE SESSIONS: LEGAL PROVISIONS

State or other jurisdiction	Regular sessions				Special sessions		
	Legislature convenes [1]			Limitation on length of session	Legislature may call [2]	Legislature may determine subject	Limitation on length of session
	Year	Month	Day				
Alabama	Annual	April	3d Tuesday (a,b)	30 L in 105 C.	No	2/3 vote, each house	12 L in 30 C.
		February	1st Tuesday				
		January	2d Tuesday (c)				
Alaska	Annual	January	3d Monday (a)	None	Vote 2/3 members	Yes(d)	30 C.
		January	2d Monday				
Arizona	Annual	January	2d Monday	None(e)	Petition 2/3 members, each house	Yes(d)	None.
Arkansas	Odd(f)	January	2d Monday	60 C(f)	No	(g)	None(g).
California	Even(h)	December	1st Monday	None	No	No	None.
Colorado	Annual(i)	January	Wednesday after 1st Tuesday	None	Vote 2/3 members, each house	Yes(d)	None.
Connecticut	Annual(i)	Odd: January	Wednesday after 1st Monday	(j)	No	No	None.
		Even: February	Wednesday after 1st Monday	(j)			
Delaware	Annual(k)	January	2d Tuesday	June 30	Joint call, presiding officers, both houses	Yes	None.
Florida	Annual	April	Tuesday after 1st Monday(b)	60 C(f)	do	Yes	20 C(f).
Georgia	Annual(k)	January	2d Monday	40 L	Petition 3/5 members, each house	Yes(d)	(l).
Hawaii	Annual(k)	January	3d Wednesday	60 L(f)	Petition 2/3 members, each house	Yes	30 L(f).
Idaho	Annual	January	Monday on or nearest 9th day	None	No	No	20 C.
Illinois	Annual(k)	January	2d Wednesday	None	Joint call, presiding officers, both houses	Yes	None.
Indiana	Annual	January	2d Monday(b)	Odd: 61 L or Apr. 30	No	Yes	30 L in 40 C.
				Even: 30 L or Mar. 15			
Iowa	Annual(k)	January	2d Monday	None(m)	Petition 2/3 members, each house	Yes	None.
Kansas	Annual(k)	January	2d Monday	Odd: None; Even: 90 C(f)	Petition to governor of 2/3 members, each house	Yes	None.
Kentucky	Even	January	Tuesday after 1st Monday	60 L	No	No	None.
Louisiana	Annual	April	3d Monday	60 L in 85 C.	Petition majority, each house	Yes(d)	30 C.
Maine	Even(h)	December	1st Wednesday	100 L	Vote of majority of each party, each house	Yes(d)	None.
	Even(i)	January	1st Wednesday after 1st Tuesday	50 L			
Maryland	Annual	January	2d Wednesday	90 C(f,n)	Petition majority, each house	Yes	30 C.
Massachusetts	Annual	January	1st Wednesday	None	Yes	Yes	None.
Michigan	Annual(k)	January	1st Wednesday	None	No	No	None.
Minnesota	Odd(o)	January	Tuesday after 1st Monday	120 L or 1st Monday after 3d Saturday in May.	No	Yes	None.
Mississippi	Annual	January	Tuesday after 1st Monday	(f,p)	No	No	None.
Missouri	Annual	January	Wednesday after 1st Monday	Odd: June 30	No	No	60 C.
				Even: May 15			

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TABLE 15.—LEGISLATIVE SESSIONS: LEGAL PROVISIONS—Continued

State or other jurisdiction	Regular sessions				Special sessions		
	Legislature convenes [1]			Limitation on length of session	Legislature may call [2]	Legislature may determine subject	Limitation on length of session
	Year	Month	Day				
Montana	Odd	January	1st Monday(q)	90 L	Petition majority, each house	Yes	None.
Nebraska	Annual(k)	January	1st Wednesday after 1st Monday	Odd: 90 L(f) Even: 60 L(f)	Petition 2/3 members	Yes	None.
Nevada	Odd	January	3d Monday	60 C(m)	No	No	20 C(m)
New Hampshire	Odd	January	1st Wednesday after 1st Tuesday(b).	(m)	Yes	Yes	None(m)
New Jersey	Annual	January	2d Tuesday	None	Petition majority, each house	Yes	None.
New Mexico	Annual(i)	January	3d Tuesday	Odd: 60 C; Even: 30 C	Petition 3/5 members, each house	Yes(d)	30 C.
New York	Annual(k)	January	Wednesday after 1st Monday	None	Petition 2/3 members, each house	Yes(d)	None
North Carolina	Odd(o)	January	Wednesday after 2d Monday	None	Petition 3/5 members, each house	Yes	None.
North Dakota	Odd	January	1st Tuesday after 3d day(b,q)	80 L	No	Yes	None.
Ohio	Annual	January	1st Monday(q)	None	Joint call, presiding officers, both houses	Yes	None.
Oklahoma	Annual(k)	January	Tuesday after 1st Monday	90 L	Vote 2/3 members, each house	Yes	None.
Oregon	Odd	January	2d Monday	None	Petition majority, each house	Yes	None.
Pennsylvania	Annual(k)	January	1st Tuesday	None	...do	No	None.
Rhode Island	Annual(k)	January	1st Tuesday	60 L(m)	No	No	None.
South Carolina	Annual(k)	January	2d Tuesday	1st Thursday in June(f)	No	Yes	None.
South Dakota	Annual	January	Odd: Tuesday after 1st Monday Even: Tuesday after 1st Monday	40 L 35 L	No	No	None.
Tennessee	Odd(o)	January	1st Tuesday(b)	90 L(m)	Petition 2/3 members, each house	Yes	30(m).
Texas	Odd	January	2d Tuesday	140 C	No	No	30 C.
Utah	Annual(i)	January	2d Monday	Odd: 60 C; Even: 20 C	No	No	30 C.
Vermont	Odd(o)	January	Wednesday after 1st Monday	None(m)	No	Yes	None.
Virginia	Annual(k)	January	2d Wednesday	Even: 60 C(f) Odd: 30 C(f)	Petition 2/3 members, each house	Yes	None.
Washington	Annual	January	2d Monday	Odd: 105 C; Even: 60 C	Petition 2/3 members, each house	Yes	30 C.
West Virginia	Annual	January	2d Wednesday(r)	60 C(f,n)	Petition 3/5 members, each house	Yes(s)	None.
Wisconsin	Annual	January	1st Tuesday after Jan. 8(t)	None	No	No	None.
Wyoming	Annual(j)	January	Odd: 2d Tuesday	40 L	No	Yes	None.
		February	Even: 2d Tuesday	20 L			
American Samoa	Annual	January	2d Monday	45 L	No	No	None.
		July	2d Monday	45 L			

Guam	Annual(k)	January	1st Monday(u)	None	No	No	None.
Puerto Rico	Annual(k)	January	2d Monday	Apr. 30(t)	No	No	20 C.
Virgin Islands	Annual(k)	January	2d Monday	75 L	No	No	15 C.

[1] All states elect new legislatures in November of even-numbered years except Kentucky, Louisiana, Mississippi, New Jersey and Virginia. Alabama, Louisiana, Maryland and Mississippi elect all legislators at the same time to 4-year terms.
[2] The following states provide for a special session only to consider bills vetoed after adjournment sine die: Connecticut, Hawaii, Louisiana, Missouri (even years only), Utah, Virginia and Washington.

Notes.—Key: L—Legislative day, C—Calendar day, and N—Natural day.

(a) In the year immediately following the quadrennial general election.

(b) Legislature meets in organizational session. Alabama: second Tuesday in January after quadrennial election. Florida: fourteenth day following each general election. Indiana: third Tuesday after first Monday in November for one day only. New Hampshire: first Wednesday of December, even-numbered years. North Dakota: first Tuesday afer first Monday in December in even years. South Carolina: first Tuesday after certification of the election of its members for no more than three days. Tennessee: first Tuesday in January for no more than 15 C days to organize and introduce bills; reconvenes on first Tuesday next following the conclusion of the organizational session, unless the General Assembly by joint resolution sets another date.

(c) During the election year.

(d) Only if legislature convenes itself. Special sessions called by the legislature are unlimited in scope in Arizona, Georgia, Maine and New Mexico.

(e) House and Senate rules require that regular sessions be adjourned sine die no later than the third Friday in April of each year.

(f) Session may be extended for an indefinite period of time by vote of members in both houses. Arkansas: 2/3 vote. Florida: 3/5 vote. Hawaii: petition of 2/3 membership for not more than 15 days. Kansas: 2/3 vote elected members. Maryland: 3/5 vote for 30 additional days. Mississippi: 2/3 vote of those present may extend for 30 C days, no limit on extensions. Nebraska: 4/5 vote. South Carolina: concurrent resolution, 2/3 vote, both houses. Virginia: 2/3 members, each house, for up to 30 days. West Virginia: 2/3 vote. Puerto Rico: joint resolution.

(g) After the legislature has disposed of the subject(s) in the governor's call, it may be a 2/3 vote of members of both houses take up subject(s) of its own choosing in a session of up to 15 days.

(h) Regular sessions commence in December of each even-numbered year following the general election. California: the legislature continues in session until November 30 of the next even-numbered year. It may recess from time to time and may be recalled into regular session.

(i) Second session of legislature is basically limited to budget and fiscal matters. Exceptions: Colorado—items on governor's call; Maine—legislation; in the governor's call, study committee legislation and initiated measures; New Mexico—legislature may consider bills vetoed by the governor at the preceding session; Utah—legislature may consider non-budget matters after 2/3 vote of each house.

(j) Odd years: not later than first Wednesday after first Monday in June; even years: not later than first Wednesday after first Monday in May.

(k) The legislature meets in two annual sessions, each adjourning sine die. Bills carry over from first to second session. Delaware, Illinois, Virgin Islands: legislature adjourns sine die at end of second year only; Puerto Rico: four annual sessions.

(l) Limited to 70 days if called by governor and 30 days if called at petition of legislature, except for impeachment proceedings.

(m) Indirect restrictions only since legislator's pay, per diem, or daily allowance stops, but session may continue. Iowa: limit on per diem expenses, 120 days first session, 100 days second session. Nevada: limit on pay only. New Hampshire: constitutional limit on expenses of 90 days or July 1, whichever occurs first, 15 days salary and expenses for special session. Tennessee: constitutional limit on per diem and travel allowance only, excluding organizational session.

(n) Governor must extend until the general appropriation is passed.

(o) The legislature may divide and in practice has divided the session to meet in even years also.

(p) The first session of a new legislature. Every other even year of the gubernatorial item is limited to 125 C days; odd years 90 C days.

(q) If the first day falls on a legal holiday: Montana—following Wednesday; North Dakota—or falls on January 2, a date to be selected by the Legislative Council between Jan. 2 and Jan. 11; Ohio—the day after.

(r) Following each gubernatorial election, the legislature convenes on the second Wednesday of January to organize but recesses until the second Wednesday in February for the start of the 60-day session.

(s) According to a 1955 attorney general's opinion, when the legislature has petitioned to the governor to be called into session, it may then act on any matter.

(t) The legislature by joint resolution establishes the session schedule of activity for the remainder of the biennium at the beginning of the odd-numbered year. These dates may be subject to change.

(u) The legislature meets on the first Monday of each month following its initial session in January.

STATEMENT OF MUTUAL OF OMAHA INSURANCE CO. AND UNITED OF OMAHA LIFE INSURANCE CO.

DESCRIPTION OF AMENDMENT TO SECTION 809

Present law

The Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA") amended section 809 to provide that dividends to policyholders reimbursed to the taxpayer by a reinsurer pursuant to a reinsurance agreement were to be included in the taxpayer's gross amount and deductible by the taxpayer subject to any applicable dividend limitation. The provision was intended to prevent insurance companies from avoiding the limits on dividends to policyholders through reinsurance.

Background

Because Mutual of Omaha, an assessment casualty company formed in 1909, was unable to write life insurance products and unable to meet the financial requirements to change its status to a life insurance company, officers, directors, agents, and others with close affiliations with Mutual formed a stock life insurance company, United of Omaha Life Insurance Company, in 1926. For a number of years, both companies wrote health and accident business. In its Triennial Examination for 1943-45, the National Association of Insurance Commissioners ("NAIC") raised, among other problems, a question regarding the affiliate operation of a mutual and a stock company both writing health and accident business through a common agency force in competition with each other. For the first and only time in its history, the NAIC appointed a special subcommittee to make recommendations for resolving what it viewed as a conflict of interest between the two companies.

In addition to recommending that Mutual but substantially all of United's outstanding stock, in 1955 the subcommittee also required United to reinsure its accident and health insurance business with Mutual. As a result, on June 29, 1955, the two companies entered into a conventional coinsurance reinsurance agreement whereby Mutual would reinsure all of United's health and accident business written after June 1, 1955. United and Mutual are still operating under the terms of the original agreement, which required Mutual to reimburse United for any dividends paid to policyholders on the reinsured business, and both companies have structured their marketing operations accordingly.

Proposed amendment

The TEFRA amendment to section 809 concerning dividend reimbursements by a reinsurer results in an additional tax liability to United. The proposed amendment to section 809 would exempt the dividends reimbursed by Mutual to United from the current rule. Instead, those dividends would continue to be treated for federal income tax purposes as dividends of Mutual as they have been since the enactment of the Life Insurance Company Income Tax Act of 1959. Without the proposed exemption, the marketing operation of the two companies would have to be restructured with possible adverse competitive effect.

The proposed amendment is limited in scope and would apply only to reinsurance arrangements entered into prior to June 30, 1955 pursuant to the direction of the NAIC and approved by the state insurance commissioner of the taxpayer's state of domicile. To the knowledge of both United and Mutual, the proposed amendment would apply only to their reinsurance agreement entered into on June 29, 1955, and to no other reinsurance agreement. It is intended that the proposed amendment be effective as of the effective date of the TEFRA amendment of section 809.

Amendment to Section 809 of the Internal Revenue Code

Insert after Section 809(f):

"Section 809(g) Dividends to Policyholders Reimbursed By A Reinsurer.—Subsection (c)(1)(F) and subsection (d)(12) shall not apply to dividends to policyholders reimbursed to the taxpayer by a reinsurer in respect of policies reinsured under a reinsurance agreement entered into prior to June 30, 1955 pursuant to the direction of the National Association of Insurance Commissioners and approved by the state indurance commissioner of the taxpayer's state of domicile. For purposes of this Subchapter, any such dividends shall be treated as dividends of the reinsurer and not the taxpayer."

[It is intended that this amendment be effective as of the effective date of section 809(c)(1)(F) and section 809(d)(12).]

NATIONAL AIR TRANSPORTATION ASSOCIATION,
Washington, D.C., September 21, 1983.

Hon. DAN ROSTENKOWSKI,
Chairman, Committee on Ways and Means,
House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: As the representative of the nation's aviation fuel retailers, the National Air Transportation Association strongly supports the move to collect the entire 12 cent per gallon federal excise tax on aviation gasoline at the retail level, instead of the current method of collecting part of the tax at the manufacturer level and the remainder at the retail level.

This change would benefit both the aviation industry and the government. Revenues would be collected from a single source, rather than from both manufacturers and retailers, eliminating confusion that currently exists. Moreover, collecting all of the aviation gasoline tax at retail would be consistent with the tax collection method for jet fuel.

Mr. Chairman, we urge you to include this technical correction in your deliberation on H.R. 3805.

Sincerely,

LAWRENCE L. BURIAN, *President.*

Attachments.

CHEVRON U.S.A. INC.,
San Francisco, Calif., February 3, 1983.

MR. WILLIAM A. POWER,
Director, Legislative and Industry Affairs,
National Air Transportation Association,
Washington, D.C.

DEAR MR. POWER: Confirming our earlier telephone conversations, Chevron U.S.A. has no objection to shifting collection of all federal excise taxes on aviation gasoline from the manufacturer to the retailer.

Chevron would have no problem changing accounting and billing mechanisms to an ex-tax basis while continuing to collect taxes on motor gasoline. In fact, our administrative burden would be reduced somewhat. As you know, this would make for consistent tax collection on aviation gasoline and jet fuel.

Should the need arise, please feel free to contact me at any time.

Very truly yours,

B. T. HENDERSON.

SHELL OIL CO.,
Houston, Tex., February 4, 1983.

MR. WILLIAM H. POWER,
Director Legislative and Industrial Affairs,
National Air Transportation Association, Inc.,
Washington, D.C.

DEAR BILL: Shell Oil Company is supportive to NATA's proposal to have the Federal Excise Tax collected and paid by airport dealers. Of course Shell will comply with the requirements of the law under circumstance.

Very truly yours,

R. A. HEUSTESS,
Manager, Aviation Sales.

EXXON COMPANY, U.S.A.,
Houston. Tex., January 24, 1983.

MR. WILLIAM H. POWER,
National Air Transportation Association,
Washington, D.C.

DEAR BILL: We have discussed your questions concerning the NATA's goal for having the 12¢ per gallon tax on avfuels collected at the retail level with our tax attorney. We take no exception to this activity, however, we cannot take a strong position on the matter, either pro or con.

While Exxon's administrative burden would be reduced if the taxes were both imposed at the retailer's level, there are also a number of factors supporting an approach that would categorize them as manufacturer's taxes. For example, the

number of taxpayers under a manufacturer's tax system is smaller, thus reducing the number of returns to be filed and promoting administrative ease. Furthermore, making the legal incidence of the total 12¢ tax, the retail level increases the risk of loss of revenues to the government because taxpayer non-compliance has historically been something of a problem with taxes at the retail level. In our experience, the excise taxes such as motor fuel taxes and sales taxes is achieved when the legal incidence is at the manufacturer's or wholesaler's level, although the tax may be separately stated and collected from the retail customer.

Because of these competing interest, Exxon can take no position on this issue beyond urging that both taxes be imposed at the same level. If you have further questions on this matter of if I may be of assistance in any way, please contact me.

Sincerely,

ED.

GAS TAX ON AVIATION GASOLINE (AVGAS)

Spokesmen for the Administration, the House and the Senate have all assured the general aviation community that the five cents gasoline user fee proposal now pending in the Congresss is not intended to be additive to the Avgas increase recently enacted in PL 97-248. However, there appear to be several alternatives as to how to collect the 12 cents tax on Avgas; at the refinery, at the pump, or a combination of the two.

Several aviation interests propose that no fees on Avgas be collected at the refinery; rather, collect the entire 12 cents at the pump for the following reasons:

Simplicity: Revenues would be collected from a single source rather than from both the manufacturer and the sales outlets, as proposed in the House bill. Moreover, it would eliminate confusion by manufacturers, dealers and customers alike.

Consistency: The current 14 cents fee on jet fuel is collected at the pump; collecting the 12 cents Avgas fee at the pump also is a logical alternative.

Convenience to the Government: Accountiing for fee revenues from a single source should simplify government collections and bookkeeping.

Purpose and Duration: Under PL 97-248, the 12 cents Avgas fee goes into the Airport and Airways Trust Fund, and this authority expires in 1986. The pending legislation is to be effective until 1988. At that time, Avgas fees collected at the refinery—in the absence of renewed Airport/Airway authorization—would undoubtedly be paid into the Highway Trust Fund. This could become a highly-controversial breech of the user fee concept.

We urge that the entire 12 cents per gallon Avgas user fee be collected at the pump.

In order to provide that aviation gasoline would be taxed one time at the retail point of sale, the tax code should be amended to delete the manufacturers excise tax and to increase the rate of special fuels excise tax accordingly. The following changes to the tax code are therefore recommended:

Section 4041 change as follows:

(c)(2) "Aviation Gasoline—There is hereby imposed a tax of 12 cents a gallon upon any aviation gasoline—"

(A) and (B) remain unchanged.

Delete (3) and renumber (4) and (5) to (3) and (4) respectively.

Section 4081 add the following:

"(d) Aviation Gasoline—Under regulations prescribed by the Secretary, no tax shall be imposed by this section on the sale of any aviation gasoline."

Section 4082 add the following:

(b) Delete "." and add to end of last sentence:", other than gasoline manufactured to be suitable for use in aircraft."

"(e) Aviation Gasoline—As used in this subpart, the term "aviation gasoline" means all products commonly or commercially known or sold as suitable for use as a motor fuel in reciprocating engine powered aircraft."

NATIONAL ASSOCIATION OF COLLEGE AND
UNIVERSITY BUSINESS OFFICERS,
Washington, D.C., September 28, 1983.

Mr. JOHN J. SALMON,
Chief Counsel, Committee on Ways and Means,
House of Representatives, Washington, D.C.

DEAR MR. SALMON: The National Association of College and University Business Officers (NACUBO), an organization representing nearly 2,000 colleges and universities, would like to offer for the record these comments on the Technical Corrections Act, H.R. 3805.

The association on behalf of its members wishes to urge that Section 402(g) of H. R. 3805 be deleted or, at least, significantly modified. Section 402(g) would amend Section 327(d) of P. L. 98-21, the Social Security Amendments of 1983. Altered would be the effective date of the changes in Section 3121(a)(5) of the Internal Revenue Code made by Section 324(a)(2) of the Social Security Amendments of 1983. Under Section 324(a)(2), that portion of contributions made by an employer, such as a college or university exempt from federal taxation under IRC Section 501(c)(3), toward the purchase of an IRC Section 403(b) annuity that results from a salary reduction agreement will be treated as wages for FICA purposes after Janaury 1, 1984. Under Section 402(g) of H. R. 3805, the effective date would be moved back to March 4, 1983. Moreover, the change would apply to "remuneration paid on or before date *which the employer treated as wages when paid.*" (Emphasis added.)

At the outset, we would suggest that a "technical corrections act" is not the proper vehicle for such a change in the Social Security Amendments of 1983. The retroactive provision is not a technical correction but a major change in the law. Whatever can be said about moving the effective date back to March 4, 1983, further retroactivity is not a technical correction. Moreover, it is unfair and prevents employees and employers from seeking judicial redress to recoup taxes erroneously withheld, leaving them no legal recourse.

It is clear that Congress was fully aware of all the facts and circumstances when it enacted Section 324(a)(2). As noted in the report of the Senate Finance Committee with respect to S. 1, the bill which lead to the Social Security Amendments of 1983:

"The Internal Revenue Service has ruled (Revenue Ruling 65-208, 1965-2 C. B. 383) that amounts paid for a tax-sheltered annuity pursuant to a salary reduction agreement are includible in the employee's social security wage base, even though such amounts may not be subject to income tax withholding." (Senate Report 98-23, 98th Congress, 1st Session, page 39.)

It is clear that the amounts used by an exempt Section 501(c)(3) employer to purchase a Section 403(b) annuity for one of its employees are not subject to federal income tax, including any portion resulting from a salary reduction agreement. (See Regulations 1.403(b)-1(b)(3).)

[I]n *"Rowan Companies, Inc.* v. *United States,* 452 U.S. 247 (1981), the Supreme Court held that the definition of wages for social security tax purposes must be interpreted in regulations in the same manner in the absence of statutory provisions to the contrary."(Senate Report 98-23, supra, page 42.)

As a result, "the validity of the ruling position is in doubt in light of the Supreme Court decision in *Rowan Companies, Inc.* v. *United States.*" (Senate Report 98-23, supra, page 42.)

By providing in Section 327(d)(7) of P. L. 98-21 that the effective date of this change should apply to amounts paid after December 31, 1983, Congress in no way could be said to have made a technical error.

The change which would make the Act effective for remuneration paid on or before March 4, 1983, which the employers treated as wages when paid, is particularly onerous and unfair. Not only is it clearly intended to deny employers and employees refunds for the period previous to the change in the law, but it may be so arbitrary and capricious in its application as to amount to a denial of due process under the Constitution. (See *Gillmor* v. *Quinlivan,* 143 F. Supp. 440.) The effect is that, where an employer, by intent or mistake, failed to withhold on payments toward the purchase of annuities for employees which were derived from a salary reduction agreement, such payments will not be subject to the FICA tax. Only where the amount was withheld will employers and employees be subject to the tax, despite the holding in *Rowan* which, *arguendo,* would call for a refund which, in fact, many colleges and universities have claimed and some have received. This rewards the careless or those who flout the Internal Revenue Service official pronouncements. On the other hand, it penalizes taxpayers who are careful and abide by Internal Revenue Service rulings even though they believe the rulings are incorrect.

NACUBO does not object to the change in the Social Security Amendments of 1983 that prospectively made employer payments toward the purchase of a Section 403(b) annuity pursuant to a salary reduction agreement subject to withholding for FICA purposes. NACUBO does urge that the change in the effective date, particularly the change that is retroactive only where withholding has occurred, is arbitrary, capricious, and unfair, and should be deleted.

Very truly yours,

D.F. FINN, *Executive Vice President.*

NATIONAL BUSINESS AIRCRAFT ASSOCIATION, INC.,
Washington, D.C., September 21, 1983.

Hon. DAN ROSTENKOWSKI,
Chairman, House Committee on Ways and Means,
Washington, D.C.

DEAR MR. CHAIRMAN: The National Business Aircraft Association (NBAA) consists of over 2600 member companies which own and operate aircraft of all types and models. Most NBAA members use their aircraft to meet their own air transportation requirements and operate as non-commercial flights. Consequently, they pay federal excise taxes on the fuel they purchase.

On behalf of NBAA members and their fuel supplies, we wish to go on record with your Committee as supporting a proposed technical correction to tax code to correct the situation under which the manufacturer's excise tax on gasoline, a tax applicable to motor fuels, is applied to aviation gasolines. Under the current law, aviation gasoline must be taxed twice; first at the point of manufacture, as gasoline, and then at the point of sale, as a special motor fuel.

Proposed language is attached by which aviation gasoline would be removed from the items taxed at the point of manufacture in favor of a total tax of twelve cents per gallon, charged at the point of delivery into the aircraft.

The proposed technical correction would yield these benefits:

Simplicity: Revenues would be collected from a single source rather than from both the manufacturer and the sales outlets, as in current law. Moreover, it would eliminate confusion of manufacturers, dealers and customers alike.

Consistency: The current 14 cents per gallon tax on jet fuel is collected at the pump; collecting the twelve cents aviation gasoline tax at the pump is a logical change.

Convenience to the Government: Accounting for tax revenues from a single source should simplify government collections and bookkeeping.

We strongly urge that the entire twelve cents per gallon aviation fuel tax be collected at the pump and hope that you will contact us should any questions on this proposed technical correction arise.

Thanking you in advance,

JOHN H. WINANT, *President.*

Attachment.

In order to provide that aviation gasoline would be taxed one time at the retail point of sale, the tax code should be amended to delete the manufacturers excise tax and to increase the rate of special fuels excise tax accordingly. The following changes to the tax code are therefore recommended:

Section 4041 change as follows:

(c)(2) "Aviation Gasoline—There is hereby imposed a tax of 12 cents a gallon upon any aviation gasoline—"

(A) and (B) remain unchanged.

Delete (3) and renumber (4) and (5) to (3) and (4) respectively.

Section 4081 add the following:

"(c) Aviation Gasoline—Under regulations prescribed by the Secretary, no tax shall be imposed by this section on the sale of any aviation gasoline."

Section 4082 add the following:

(c) Delete "." and add to end of last sentence:", other than gasoline manufactured to be suitable for use in aircraft."

"(e) Aviation Gasoline—As used in this subpart, the term "aviation gasoline" means all products commonly or commercially known or sold as suitable for use as a motor fuel in reciprocating engine powered aircraft."

NATIONAL COORDINATING COMMITTEE FOR MULTIEMPLOYER PLANS,
Washington, D.C., September 8, 1983.

Hon. DAN ROSTENKOWSKI,
Chairman, Ways and Means Committee,
Washington, D.C.

DEAR MR. CHAIRMAN: On behalf of the National Coordinating Committee for Multiemployer Plans,[1] we urge you to consider including the attached technical correction to TEFRA section 240 in the Technical Corrections Act of 1983, H.R. 3805. Section 240 added to the Internal Revenue Code ("Code") a new section 416 which sets forth special rules for top-heavy plans. In general, a plan is considered top-heavy if the present value of the cumulative accrued benefits or aggregate account balances for certain officers and owners ("key employees") of the employer exceeds 60 percent of the present value of the cumulative accrued benefits or aggregate account balances of all employees under the plan. Code § 416(g).

The facts are that a multiemployer plan cannot be top-heavy, and that the sanctions applicable to top-heavy plans have no relevance in the multiemployer plan context.

The vast majority of multiemployer plan participants are bargaining-unit employees who are generally not officers or owners of an employer and therefore not key employees. Further, most multiemployer plans provide non-integrated flat dollar benefits that are unrelated to compensation. Thus, larger dollar benefit amounts are ordinarily based on longer terms of covered service rather than the higher pay that typically accompanies company ownership or officer status. The few key employees that might be covered by multiemployer plans would therefore have no advantage over non-key employees with respect to benefit accrual. It would be virtually impossible for a multiemployer plan to satisfy the definitional top-heaviness test of providing in excess of 60 percent of its benefits to key employees.

Even if a multiemployer plan could be top-heavy, it would not be subject to the major top-heavy requirements, i.e., Code section 416 (b), (c) and (d) requirements relating to faster vesting, minimum benefits or contributions, and a celing on the amount of compensation that may be used to compute benefits. Code § 416(i)(4); Prop. Treas. Reg. § 1.416–1 Q&A T–2. Application of the remaining top-heavy requirements (the Code section 416(h) adjustment in the section 416 limits, the Code section 401(a)(9) distribution restrictions and the Code section 72(m)(5) excise tax on certain distributions to key employees) would provide no meaningful protection to multiemployer plan participants and would correct no abuses.[2] Nevertheless, application of the top-heavy plan provisions to multiemployer plans would impose significant burdens on such plans, including the Code section 401(a)(10)(b) requirement that all plans adopt boilerplate language to take effect if they become top-heavy.

For these reasons, we believe it would be unreasonable to subject multiemployer plans to the top-heavy plan provisions of the Code. We therefore urge you to consider the attached technical correction, which would make it clear that multiemployer plans are exempted from the top-heavy plan requirements, including the requirement to adopt boilerplate, top-heavy plan provisions that will almost certainly never become effective. The Secretary is, however, empowered to promulgate regulations limiting this exemption where necessary to prevent abuses.

The suggested technical correction also makes it clear that, for purposes of determining the top-heavy status of an employer's single employer plans, employers are to aggregate their share of the accrued liabilities of any multiemployer plan to which they contribute as though it were a separate plan.

If you have any questions, or if we can be of any assistance on this matter, please be in touch with Paul S. Berger (872–6784), Peter Schmidt (872–6834) of Vivian Bersinski (872–8610).

With kind regards, I am,
Sincerely,

ROBERT A. GEORGINE, *Chairman.*

Enclosure.

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[1] The NCCMP is a nonprofit, tax-exempt organization established after Congress enacted ERISA in 1979. The NCCMP consists of representatives of approximately one hundred thirty-five pension and welfare plans, or their sponsors, through which, in the aggregate, the interests of approximately 3 million persons are represented. On behalf of its affiliated multiemployer plans and their participants and beneficiaries, the NCCMP is entirely engaged in monitoring the development—legislative, administrative, and judicial—of the laws relating to the structuring and administration of multiemployer pension and welfare plans.

[2] See the attached comments which were submitted to the Commissioner of Internal Revenue by the NCCMP in connection with recently proposed Treasury regulations on top-heavy plans.

The following new subparagraph (7) should be added to the end of subsection (f) of section 103 of the Technical Corrections Act of 1983, H.R. 3805:

(7) Treatment of multiemployer plans.

(A) Definition of "top-heavy plan."—Paragraph (1) of section 416(g) is amended by the addition of the following subparagraph (C): 'The term "top-heavy plan" shall not include any multiemployer plan, except to the extent otherwise provided by regulation.'

(B) Aggregation.—Subparagraph (A) of section 416(g)(2) is amended by the addition of the following:

(iii) For purposes of determining the top-heavy status of an employer's single employer plans,

(I) such employer's share of the accrued liabilities of any multiemployer plan to which the employer contributes shall be deemed to be accrued liabilities of a "plan of the employer" within the meaning of section 416(g)(2) (i) and (ii), and

(II) unless the trustees of the multiemployer plan elect to determine contributing employers' shares of accrued liability by another method acceptable to the Secretary, such determination shall be made by use of an allocation formula based upon each employer's share of contributions to the multiemployer plan and approved by the Secretary in regulations.

(C) Plans which may become top-heavy.—Subparagraph (B)(ii) of section 401(a)(10) is amended by the addition after the parenthetical of the following: ", other than a multiemployer plan,".

NATIONAL COORDINATING COMMITTEE FOR MULTIEMPLOYER PLANS,
Washington, D.C., May 18, 1983.

COMMISSIONER OF INTERNAL REVENUE,
1111 Constitution Avenue, N.W.
Washington, D.C.

DEAR SIR: On behalf of the National Coordinating Committee for Multiemployer Plans,[1] we are pleased to provide our comments on the recently proposed Treasury regulations on top-heavy plans.

We believe the final regulations should expressly state that multiemployer plans cannot be top-heavy and need not include provisions that would take effect if they could somehow become top-heavy. The regulations should also state that employers are always permitted, if not required, to aggregate any multiemployer coverage with their single employer plans for purposes of determining the top-heavy status of such single employer plans. For this purpose, the allocation of each employer's share of the multiemployer plan's accrued liabilities should be based, in some fashion, on the employer's share of contributions to the plan, unless the multiemployer plan's trustees determine that it is feasible to make an attributable accounting thereof.

A. Top-Heavy Status of Multiemployer Plans.

1. Final Regulations Should State that Multiemployer Plans Cannot Be Top-Heavy.

It would be virtually impossible for a multiemployer plan to be top-heavy and the top-heavy rules would provide no meaningful protection to multiemployer plan participants and would correct no abuses even if such a plan could be top-heavy. Accordingly, we believe the final regulations should expressly provide that multiemployer plans cannot be top-heavy.

(a) Multiemployer Plans Cannot Be Top-Heavy.

In general, a plan is top-heavy if the accumulated accrued benefits or account balances under the plan for officers or certain owner-employees ("Key employees") exceed 60 percent of the cumulative accrued benefits or account balances under the plan for all employees. Internal Revenue Code of 1954, as amended ("Code") §416(g). In general, a plan is a super top-heavy plan if the cumulative accrued benefits or account balances for such key employees under the plan exceed 90 percent of the cumulative accrued benefits or account balances for all employees under the plan. Code §416(h).

It would be virtually impossible for a multiemployer plan to be top-heavy under this test. The vast majority of multiemployer plan participants are bargaining-unit employees (frequently numbering in the hundreds of thousands) and not officers or

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[1] The NCCMP is a non-profit corporation organized to represent the interests of the 8 million participants in multiemployer plans. The Committee's affiliates number in excess of 100 and include national pension and welfare plans, major international unions associated therewith, and local multiemployer trusts.

owners of an employer. Multiemployer plans, therefore, cover few, if any, key employees.[2]

Moreover, multiemployer plans are generally not integrated with Social Security. An integrated plan could provide comparatively large benefits for key employees, who are generally highly paid, and little or no benefits for non-key employees, whose compensation may be under or just slightly in excess of such a plan's integration level. Such a plan could be top-heavy even if the ratio of non-key to key employees were fairly large. This abuse does not exist in multiemployer plans. The lack of integration there generally means that any key employees would not accrue proportionately greater benefits than non-key employees.

Also, most multiemployer plans provide flat dollar rather than compensation-based benefits. Thus, any differential in the dollar amount of respective benefits is ordinarily based on the difference in terms of covered service rather than the higher pay that typically accompanies company ownership or officer status. Key employees would, therefore, have no advantage over non-key employees with respect to benefit accrual.

Thus, it would be virtually impossible for a multiemployer plan to provide in excess of 60 percent of its benefits to key employees, even in the few cases where multiemployer plans include a small number of key employees.

(b) Even if a Multiemployer Plan Could Be Top-Heavy, the Special Rules Thereby Applicable Would Provide No Meaningful Protection.

Even if a multiemployer plan could be top-heavy, the rules thereby applicable would provide no meaningful protection to multiemployer plan participants and would correct no abuses. A plan that is top-heavy within the meaning of Code section 416(g) is ordinarily subject to six diffferent requirements:

(1) Code section 416(b) requires either 3-year cliff or 6-year graded vesting;

(2) Code section 416(d) requires that no more than $200,000 compensation per year per employee be taken into account in determining benefits or contributions under the plan;

(3) Code section 416(c) requires that each non-key employee be provided with a minimum non-integrated employer provided benefit or contribution;

(4) Code section 416(h)(1) reduces the Code section 415(e) dollar limitation on combined contributions to and benefits under defined contribution and defined benefit plans maintained by the same employer; [3]

(5) Code section 401(a)(9)(A) requires top-heavy plans to begin distributions to key employees in the year they attain age 70-½;

(6) Code section 72(m)(5) subjects key employees in a top-heavy plan to a 10 percent excise tax on amounts received from such plan prior to the age of 59-½.

(i) Code Section 416(b), (c) and (d).

Collectively bargained plans have wisely been exempted from the major top-heavy requirements, i.e., the vesting, minimum benefit or contribution, and compensation ceiling requirements of Code sections 416(b), (c), and (d). Code § 416(i)(4); Prop. Treas. Reg. § 1.416–1 Q&A T–2. None of these requirements, therefore, applies to multiemployer plans, which are, by definition, collectively bargained.

Accordingly, the only top-heavy provisions that could have any relevance to multiemployer plans are the reduction in the section 415(e) limitation, the age 70-½ distribution requirement, and the 10 percent excise tax. As discussed below, treatment of multiemployer plans as top-heavy for the purpose of applying these provisions would be unproductive.

(ii) Code Section 416(h).

Plans that are merely top-heavy and not super top-heavy can avoid the reduction in the Code section 415(e) limitation by satisfying increased section 415(c) minimum contribution or benefit requirements. Code § 416(h)(2). Because multiemployer plans are not subject to these minimum contribution or benefit requirements, the reduced Code section 415(e) limitations will apparently apply to such plans only if they are super top-heavy, *i.e.*, provide in excess of 90 percent of their benefits for key employees.

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[2] Such cases arise, for example, with respect to a few plans that allow "special class" participation through which a company's salaries employees are covered as long as its union-represented employees participate. Similarly, union members who now own their own businesses, and work for themselves, may maintain continuity of coverage. Also, former bargaining-unit members with vested rights may subsequently become key employees of contributing employers. (Prop. Treas. Reg. § 416–1 Q&A T–11 states that, for purposes of determining key employee status, business organizations other than corporations do not have officers. We therefore assume that the staff members of a union or pension fund are not key employees.)

[3] A plan that is only top-heavy and not super top-heavy may avoid this reduction by increasing the minimum benefits or contributions under the plan. Code § 416(h)(2).

Under existing Code section 415 regulations, multiemployer plans are not required to be aggregated with other multiemployer plans for purposes of the Code section 415 limitations. Treas. Reg. § 1.415–8(e). Where, however, an employer maintains both a plan which is not a multiemployer plan and a multiemployer plan, the plan which is not a multiemployer plan must be aggregated with the multiemployer plan to the extent that benefits provided under the multiemployer plan are provided by such employer with respect to a common participant. Treas. Reg. § 1.415–8(e). If the terms of the plans, as so aggregated, exceed the limitation of Code section 415(e) with respect to any participant, the plan which is not a multiemployer plan, rather than the multiemployer plan, will be disqualified.[4] Treas. Reg. § 1.415–9(b)(3)(ii).

Thus, applying the reduced section 415 limitation to a multiemployer plan would produce no meaningful result. As discussed above, it would be virtually impossible for a multiemployer plan standing alone to be top-heavy. Any top-heaviness in a multiemployer plan would necessarily result from aggregation with top-heavy single employer plans. These single employer plans will be subject to the reduced section 415 limitation by virtue of their own top-heaviness regardless of the top-heavy status of the multiemployer plan.

(iii) Code Section 401(a)(9)(A).

Treatment of multiemployer plans as top-heavy for purposes of the requirement that distributions from top-heavy plans to key employees must begin in the year the key employee reaches age 70–½ would also be unproductive. The determination of a participant's key employee status requires knowledge of who the contributing employer's officers are and who owns what percentage of the employer.[5] This is not information plans currently receive and it would be difficult, if not impossible, to obtain and verify. (Contributing employers would be reluctant to provide this information to the representatives of their competitors and the unions who sit on the plans' boards of trustees.) Further, the key employee status of many participants will change over time. It would simply not be feasible to monitor continuously all of the plan's participants (frequently hundreds of thousands of individuals) to determine the occurence of such changes in key employee status.

Thus, not only will it be virtually impossible for multiemployer plans to determine whether they are top-heavy, it would also be difficult or impossible to identify the individuals to whom any "top-heavy" multiemployer plans would have to make age 70½ distributions. Also, because of the way multiemployer plan data is ordinarily organized, and because of inaccuracies or omissions in such plan's records with respect to the addresses of their participants, plans would often be unable to determine either the year in which key employee participants reached age 70½ or the whereabouts of such participants at that time.

(iv) Code Section 72(m)(5).

It would also be unworkable to treat multiemployer plans as top-heavy for purposes of the requirement that a key employee who receives benefits before age 59½ pay a 10 percent excise tax on certain payments. Such plans likely could not maintain complete, accurate and current records with respect to the key employee status of their participants. It would therefore be virtually impossible to determine whether specific contributions were made at a time when the multiemployer plan was top-heavy, thereby resulting in excise taxes on premature distributions.

2. Any Testing of Multiemployer Plans for Top-Heavy Status Should Be on a Plan-Wide Basis.

As noted earlier, we believe the regulations should simply provide that multiemployer plans cannot be considered top-heavy. However, if such plans *must* be tested for top-heaviness, any such testing should be on a plan-wide basis. As Code section 416(g)(1)(A) states, the benefits of all key employees under the plan must be compared with the benefits of all covered employees in determining top-heavy status. Nothing in this or any other section suggests anything other than a plan-wide determination.

B. Multiemployee Plans Should Not Be Required To Contain Provisions That Would Take Effect If the Plan Were To Become Top-Heavy.

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[4] However, if the single employer plan terminated at any time including the last day of the particular limitation year, the multiemployer plan, if it has not also terminated, will be disqualified. Treas. Reg. § 1.415–9(b)(3)(i).

[5] Such a determination also requires the application of rules calling for attribution of ownership, the testing of compensation on an affiliated-service-group and controlled-group basis, and the inclusion of key employees' beneficiaries as key employees. *See* Code § 416(i)(1); Prop. Treas. Reg. § 1.416–1 Q&A T–8, T–13. Application of these rules would require information difficult or impossible to obtain from the employers.

Code section 401(a)(10)(B)(ii) requires all qualified plans to contain provisions that will take effect to satisfy the top-heavy requirements of Code section 416 if the plan ever becomes top-heavy. That section, however, gives the Secretary of the Treasury statutory authority to provide exceptions to this requirement in regulations. We believe that this authority should be exercised to provide an exception for multiemployer plans.

The proposed regulations now provide as follows:

"[A]ny plan that covers only non-key employees who are included in a unit of employees covered by a collective bargaining agreement (if retirement benefits were the subject of good faith bargaining) need not include any top-heavy provisions." Prop. Treas. Reg. § 1.416–1, Q&A T–28.

Although helpful, this exception is not broad enough to avoid unnecessarily burdening many multiemployer plans. As noted above, multiemployer plans may cover a small number of key employees. Even plans that had no key employees would likely find this fact difficult to determine. Thus, most plans would probably find it less burdensome to include boilerplate contingent top-heavy language.

In light of the virtual impossibility that a multiemployer plan could be top-heavy, and the fact that none of the Code section 416 requirements would have any practical impact on a multiemployer plan even if it were top-heavy, we believe that it would be unreasonable to require such plans to contain contingent top-heavy provisions.

C. Aggregation of Single Employer Plans with Their Employer's Multiemployer Coverage.

1. Multiemployer Coverage Should Be Aggregated with Single Employer Plans.

For purposes of determining the top-heavy status of its plans, Code section 416(g)(2)(A)(i) requires an employer to aggregate each of its plans in which a key employee is a participant, together with each other plan of the employer which enables the aggregation to meet the antidiscrimination requirements of Code section 401(a)(4) or 410. All plans required to be included in this group are top-heavy if the group is top-heavy. Code § 416(g)(1)(B). Code section 416(g)(2)(A)(ii) permits an employer to aggregate any other of its plans if the resulting group would continue to meet the antidiscrimination requirements of Code sections 401(a)(4) and 410.

If these sections were construed to permit or require an employer, in testing its single employer plans for top-heaviness, to aggregate such plans with an entire multiemployer plan to which the employer contributed, multiemployer plan participation would become a safe haven to shelter the top-heaveness of an employer's other qualified plans. The Congressional purpose to protect non-key employees whose employers are providing disproportionately favorable benefits to key employees would not be achieved.

A more sensible result would be achieved by requiring or permitting (whichever is applicable) employers to aggregate their single employer plans with a multiemployer plan to the extent that benefits under the multiemployer plan are provided for that employer's employees. This would permit employers to get credit for the multiemployer coverage they provide to non-key employees and require them to take into account multiemployer coverage they provide for a group of employees including a key employee. (Under no circumstances, however, should Code section 416(g)(1)(B) be construed to make a multiemployer plan, or any part thereof, top-heavy merely because it covers key employees of employers that maintain top-heavy, single employer plans.)

2. Multiemployer Coverage Is Always Aggregable with Aggregable Single Employer Plans.

The final regulations should make clear that, for purposes of determining the top-heavy status of single employer plans, it is always permissible for an employer to aggregate the multiemployer coverage it provides for its employees. Code section 416(g)(2)(A)(ii) permits aggregation that is not otherwise required only if the combined plans "would continue to meet the requirements of sections 401(a)(4) and 410." Proposed Treasury Regulation section 1.416–1, Q&A T–4 states that this means the benefits or contributions under the plans to be aggregated must be comparable, *i.e.*, the contributions and benefits would not discriminate if the two plans were considered as a unit. For discrimination purposes, employers may ignore employees in a collective bargaining unit, if retirement benefits were the subject of good faith bargaining. Code §§ 401(a)(4), 410(b)(3)(A). Employees covered by multiemployer plans will generally, by the very nature of such plans, fall into the exception of sections 401(a)(4) and 410(b)(3). In our view, therefore, final regulations should make it clear that employers are permitted to aggregate their multiemployer coverage with their aggregable single employer plans, regardless of whether the contributions and benefits so aggregated would otherwise be considered discriminatory.

3. An Employer's Share of the Accrued Liabilities of a Multiemployer Plan Should Be Based on That Employer's Share of Contributions, Unless the Plan Trustees Determine that Attribution Is Feasible.

The Multiemployer Pension Plan Amendments Act of 1980, P.L. 96-364, recognizes that direct attribution of multiemployer plan benefits to a particular employer is not generally feasible in connection with the calculation of withdrawal liability. We expect that this will be true as well with respect to calculations necessary to test for top-heaviness. An easily administrable formula allocation will, therefore, be required to allocate each employer's share of multiemployer paln benefits, unless the multiemployer plan's trustees determine in a given case that it is feasible to make an attributable accunting thereof. For this purpose, we belive that each employer should be assigned a share of the multiemployer plan's accrued liability based, in some fashion, on that employer's share of contributions.

We note that a share of multiemployer plan contributions goes to fund unattributable liabilities. It might be argued that the use of multiemployer plan contributions as a basis for allocating the plan's accrued liabilities therefore results in an overvaluing of an individual employer's multiemployer benefits. We believe, however, that counting this portion of the plan's liabilities is consistent with the rationale underlying the top-heavy rules. An employer whose contributions are providing benefits for employees whose direct employers no longer contribute is clearly financing pensions for non-key employees. The top-heavy provisions of the Code were aimed at employers who were accumulating large amounts of tax-sheltered retirment savings for affluent individuals without providing comparable coverage for others. That is not the result when an employer contributes large amounts to a multiemployer plan that, because of its heavy past service obligation, provides relatively low accruals for currently active participants.

In conclusion, we respectfully request that the final requlations on top-heavy plans make clear the following points: Multiemployer plans cannot be top-heavy, and need not contain any contingent, top-heavy provisions. In testing for top-heaviness in single employer plans, employers are permitted, if not required, to aggregate multiemployer coverage with their single employer plans in accordance with Code section 416(g)(2)(A). For this purpose, the allocation of each employer's share of the multiemployer plan's accrued liabilities should be made on the basis of each employer's share of contributions to the multiemployer paln, unless the plan's trustees determine in a given case that it is feasible to make a precise attributable accounting thereof.

We appreciate the opportunity to present these comments. If you have any questions, or if we can be of any assistance on this matter, please be in touch with Peter Schmidt (872-6834) or Vivian Berzinski (872-8610).

Sincerely,

ROBERT A. GEORGINE.

STATEMENT OF THE NATIONAL COUNCIL ON TEACHER RETIREMENT (NCTR) AND THE NATIONAL ASSOCIATION OF STATE RETIREMENT ADMINISTRATORS (NASRA)

PROPOSED TECHNICAL AMENDMENTS TO TEFRA SECTION 401(a)(9)

Section 401(a)(9) as amended by the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), among other things, jeopardizes the qualified status of a retirement plan unless the entire remaining interest of an employee who dies either goes to his surviving spouse or is distributed to non-spouse beneficiaries within five years of his death. The only exception to this rule occurs where "the distribution of the interest of the employee has commenced and such distribution is for a term certain," where such term does not exceed the life expectancy of the employee and his spouse.

H.R. 3805, providing technical corrections to TEFRA, would amend this provision to accord two categories of dependants the same treatment as is presently accorded spouses. Those two categories are dependants as defined in IRC Section 152 who are under the age of 22 or who are permanently and totally disabled.

The TEFRA amendments to Section 401(a)(9), whether or not they are further modified by H.R. 3805, will have negligible revenue generating effects, at least as they are applied to public benefit plans. The amendments will, however, both disrupt the current practices of virtually all public retirement plans and will violate the provisions of state codes, and, in some instances, state constitutions. To assess the dislocation that the amendments to § 401(a)(9) will cause if enforced in January, 1984, as per the present schedule, the National Council on Teacher Retirement (NCTR) and the National Association of State Retirement administrators (NASRA)

conducted a survey of their memberships to assess current state and local laws and practices. The results of that survey and the position adopted by NCTR and NASRA based thereon are set forth below.

At the outset, it should be noted that NCTR is a membeship organization of 44 state and 15 local retirement systems, some of which serve teachers exclusively, others of which include other state and local employee groups. The total assets of NCTR's 44 state systems are roughly $120 billion, with some of the larger plans having assets of $10 billion (California), $8 billion (Texas) and $11 billion (New York). Together, the NCTR member plans have over 5 million active members.

NASRA's membership is comprised of the 50 state retirement systems, plus Guam, Puerto Rico and the Virgin Islands. Total member assets are roughly $110 billion and there are over 5.5 million active members in the NASRA plans.

The NCTR/NASRA questionnarire produced information regarding state law provisions that parallel the TEFRA § 401(a)(9) amendments from 34 states. Nineteen of these 34 states have code provisions that, under certain circumstances, permit *any* non-spouse beneficiary to receive annuity payments after the death of the plan participant, regardless of whether the payments are for a term certain or have commenced at the time of the member's death.[1] Although most states did not have readily accessible figures on the current numbers of such non-spouse annuitants, New York answered that its records showed 8,878. Colorado reported 2,500, Texas 2,000 and Ohio 1,800.[2]

Only two state plans, Maryland and Oklahoma, indicated that their current state laws parallel the federal law as set forth in the TEFRA amendments to § 401(a)(9). The laws in the remaining states fall into several categories: some, such as Arkansas, permit annuities to dependent children only, defining dependency as up to the age of 18 years or, if a full-time student, 23 years; [3] others, in addition to dependent children, also permit dependent parents as annuitants (Illinois and Missouri); still others include as non-spouse annuitants any dependent blood relative (Colorado, Minnesota, Kentucky) or "anyone with an insurable interest in the life of the member" (New Mexico).

Changing these provisions—which will be necessary to protect the qualified status of state and local pension plans—will require substantial amendments to state and local laws and regulations, as well as a rewrite of the related explanatory materials that are distributed to plan participants. Further, in some states, such as New York and Illinois, state constitutional provisions pose serious problems with respect to amending or altering participant and beneficiary rights. NCTR and NASRA take the position that Congress never intended this disruption to public plans and that the TEFRA amendments to § 401(a)(9) should not be applied to them. Public plans should be exempted from the requirements that effectively limit the joint annuity option to spousal annuitants and that limit the duration of the annuity to the life of the retirant and/or spouse.

The NCTR/NASRA position is consistent with the historical exemption of public plans from all of the benefit related provisions in ERISA, including § 401(a)(9). That exemption policy remains firmly in place and it should not be eroded piecemeal by amendments similar to those currently before the Committee. Exception of public plans from the § 401(a)(9) amendments will save the states and localities from a burdensome rewrite of the relevant laws (undertaken at the risk of plan disqualification) and will have minimal impact on the national fisc. NCTR and NASRS urge this Committee to amend H.R. 3805 to exempt public plans from the offensive portions of § 401(a)(9).

NCTR and NASRA further contend that the current effective date of the TEFRA amendments to § 401(a)(9)—January, 1984—is unrealistic and will impose an undue burden on the states. Although the state pension plans represented by the two organizations generally oppose federal preemption of state laws, they particularly oppose it when the preemption is effected in a manner that disrupts orderly business proce-

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[1] Ohio's statute is typical of this group of states. It provides that a retirant can elect either a lump sum payment or the actuarial equivalent in periodic payments. Payment under the latter can be made to any sole beneficiary named at retirement. The Ohio Code also gives certain beneficiaries the right to elect monthly payments at the time of the member's death. These include: the spouse, the dependent child (any unmarried child under age 18 or age 22 if attending school or any physically or mentally incompetent child) or any dependent parent of the deceased.

[2] NCTR assumes that existing non-spouse annuitants who would otherwise be in violation of the terms of the TEFRA amendments to § 401(a)(9) will be "grandfathered" and permitted to receive payments until death.

[3] It should be noted that most state laws carving out an exception for students use 23 rather than 22.

dures. More specifically, the NCTR and NASRA members take the position that Congress, in preempting state law, unless it is preventing a serious and immediate harm, should give the states sufficient time to bring their own laws into conformance with the new federal initiative before the latter is enforced. In regard to TEFRA § 401(a)(9), this means a grace period of two years to permit those legislatures that meet only once every two years to address the issue in their next legislative sessions. A list of the states indicating the frequency with which their legislatures meet is attached.

[From the Book of the States 1982-1983, vol. 24]

TABLE 15.—LEGISLATIVE SESSIONS: LEGAL PROVISIONS

State or other jurisdiction	Regular sessions				Special sessions		
	Legislature convenes[1]			Limitation on length of session	Legislature may call[2]	Legislature may determine subject	Limitation on length of session
	Year	Month	Day				
Alabama	Annual	April	3d Tuesday (a,b)	30 L in 105 C	No	2/3 vote each house	12 L in 30 C.
		February	1st Tuesday				
		January	2d Tuesday (c)				
Alaska	Annual	January	3d Monday (a)	None	Vote 2/3 members	Yes(d)	30 C.
		January	2d Monday				
Arizona	Annual	January	2d Monday	None(e)	Petition 2/3 members each house	Yes(d)	None.
Arkansas	Odd(f)	January	2d Monday	60 C(f)	No	(g)	None(g).
California	Even(h)	December	1st Monday	None	No	No	None.
Colorado	Annual(i)	January	Wednesday After 1st Tuesday	None	Vote 2/3 members, each house	Yes(d)	None.
Connecticut	Annual(i)	Odd: January	Wednesday after 1st Monday	(j)	No	No	None.
		Even: February	Wednesday after 1st Monday	(j)			
Delaware	Annual(k)	January	2d Tuesday	June 30	Joint call, presiding officers, both houses	Yes	None.
Florida	Annual	April	Tuesday after 1st Monday(b)	60 C(f)	do	Yes	20 C(f).
Georgia	Annual(k)	January	2d Monday	40 L	Petition 3/5 members, each house	Yes(d)	(l).
Hawaii	Annual(k)	January	3d Wednesday	60 L(f)	Petition 2/3 members each house	Yes	30 L(f).
Idaho	Annual	January	Monday on or nearest 9th day	None	No	No	20 C.
Illinois	Annual(k)	January	2d Wednesday	None	Joint call, presiding officers, both houses	Yes	None.
Indiana	Annual	January	2d Monday(b)	Odd: 61 L or April 30 Even: 30 L or March 15	No	Yes	30 L in 40 C.
Iowa	Annual(k)	January	2d Monday	None(m)	Petition 2/3 members, each house	Yes	None.
Kansas	Annual(k)	January	2d Monday	Odd: None; Even: 90 C(f)	Petition to governor of 2/3 members, each house	Yes	None.
Kentucky	Even	January	Tuesday after 1st Monday	60 L	No	No	None.
Louisiana	Annual	April	3d Monday	60 L in 85 C	Petition majority, each house	Yes(d)	30 C.
Maine	Even(h)	December	1st Wednesday	100 L	Vote of majority of each party, each house	Yes(d)	None.
	Even(i)	January	1st Wednesday after 1st Tuesday	50 L			
Maryland	Annual	January	2d Wednesday	90 C(f,n)	Petition majority, each house	Yes	30 C.
Massachusetts	Annual	January	1st Wednesday	None	Yes	Yes	None.
Michigan	Annual(k)	January	1st Wednesday	None	No	No	None.
Minnesota	Odd(o)	January	Tuesday after 1st Monday	120 L or 1st Monday after 3d Saturday in May.	No	Yes	None.
Mississippi	Annual	January	Tuesday after 1st Monday	(f,p)	No	No	None.
Missouri	Annual	January	Wednesday after 1st Monday	Odd: June 30 Even: May 15	No	No	60 C.

TABLE 15.—LEGISLATIVE SESSIONS: LEGAL PROVISIONS—Continued

State or other jurisdiction	Regular sessions				Special sessions		
	Legislature convenes[1]			Limitation on length of session	Legislature may call [2]	Legislature may determine subject	Limitation on length of session
	Year	Month	Day				
Montana	Odd	January	1st Monday(q)	90 L	Petition majority, each house	Yes	None.
Nebraska	Annual(k)	January	1st Wednesday after 1st Monday	Odd: 90 L(f) Even: 60 L(f)	Petition 2/3 members	Yes	None.
Nevada	Odd	January	3d Monday	60 C(m)	No	No	20 C(m)
New Hampshire	Odd	January	1st Wednesday after 1st Tuesday	(m)	Yes	Yes	None(m)
New Jersey	Annual	January	2d Tuesday	None	Petition majority, each house	Yes	None.
New Mexico	Annual(i)	January	3d Tuesday	Odd: 60 C; Even: 30 C	petition 3/5 members, each house	Yes(d)	30 C.
New York	Annual(k)	January	Wednesday after 1st Monday	None	Petition 2/3 members, each house	Yes(d)	None.
North Carolina	Odd(o)	January	Wednesday after 2d Monday	None	Petition 3/5 members, each house	Yes	None.
North Dakota	Odd	January	1st Tuesday after 3d day(b,q)	80 L	No	Yes	None.
Ohio	Annual	January	1st Monday(q)	None	Joint call, presiding officers, both houses	Yes	None.
Oklahoma	Annual(k)	January	Tuesday after 1st Monday	90 L	Vote 2/3 members, each house	Yes	None.
Oregon	Odd	January	2d Monday	None	Petition majority, each house	Yes	None.
Pennsylvania	Annual(k)	January	1st Tuesday	None	do	No	None.
Rhode Island	Annual(k)	January	1st Tuesday	60 L(m)	No	No	None.
South Carolina	Annual(k)	January	2d Tuesday (b)	1st Thursday in June(f)	No	Yes	None.
South Dakota	Annual	January	Odd: Tuesday after 1st Monday Even: Tuesday after 1st Monday	40 L 35 L	No	No	None.
Tennessee	Odd(o)	January	1st Tuesday(b)	90 L(m)	Petition 2/3 members, each house	Yes	30(m).
Texas	Odd	January	2d Tuesday	140 C	No	No	30 C.
Utah	Annual(i)	January	2d Monday	Odd: 60 C; Even: 20 C	No	No	30 C.
Vermont	Odd(o)	January	Wednesday after 1st Monday	None(m)	No	Yes	None.
Virginia	Annual(k)	January	2d Wednesday	Even: 60 C(f) Odd: 30 C(f)	Petition 2/3 members, each house	Yes	None.
Washington	Annual	January	2d Monday	Odd; 105 C; Even: 60 C	Petition 2/3 members, each house	Yes	30 C.
West Virginia	Annual	January	2d Wednesday(r)	60 C(f,n)	Petition 3/5 members, each house	Yes(s)	None.
Wisconsin	Annual	January	1st Tuesday after January 3(t)	None	No	No	None.
Wyoming	Annual(i)	January February	Odd: 2d Tuesday Even: 2d Tuesday	40 L 20 L	No	Yes	None.

American Samoa	Annual	January	2d Monday	45 L	No	No	None.
		July	2d Monday	45 L			
Guam	Annual(k)	January	1st Monday(u)	None	No	No	None.
Puerto Rico	Annual(k)	January	2d Monday	April 30(f)	No	No	20 C.
Virgin Island	Annual(k)	January	2d Monday	75 L	No	No	15 C.

[1] All states elect new legislatures in November of even-numbered years except Kentucky, Louisiana, Mississippi, New Jersey and Virginia. Alabama, Louisiana, Maryland and Mississippi elect all legislators at the same time to 4-year terms.
[2] The following states provide for a special session only to consider bills vetoed after adjournment sine die: Connecticut, Hawaii, Louisiana, Missouri (even years only), Utah, Virginia and Washington.

Notes.—Key: L—Legislative day, C—Calendar day, and N—Natural day.

(a) In the year immediately following the quadrennial general election.

(b) Legislature meets in organizational session. Alabama: second Tuesday in January after quadrennial election. Florida: fourteenth day following each general election. Indiana: third Tuesday after first Monday in November for one day only. New Hampshire: first Wednesday of December, even-numbered years. North Dakota: first Tuesday after first Monday in December in even years. South Carolina: first Tuesday after certification of the election of its members for no more than three days. Tennessee: first Tuesday in January for no more than 15 C days to organize and introduce bills; reconvenes on first Tuesday next following the conclusion of the organizational session, unless the General Assembly by joint resolution sets another date.

(c) During the election year.

(d) Only if legislature convenes itself. Special sessions called by the legislature are unlimited in scope in Arizona, Georgia, Maine and New Mexico.

(e) House and Senate rules require that regular sessions be adjourned sine die no later than the third Friday in April of each year.

(f) Session may be extended for an indefinite period of time by vote of members in both houses. Arkansas: 2/3 vote. Florida: 3/5 vote. Hawaii: petition of 2/3 membership for not more than 15 days. Kansas: 2/3 vote elected members. Maryland: 3/5 vote for 30 additional days. Mississippi: 2/3 vote of those present may extend for 30 C days, no limit on extensions. Nebraska: 4/5 vote. South Carolina: concurrent resolution, 2/3 vote, both houses. Virginia: 2/3 members, each house, for up to 30 days. West Virginia: 2/3 vote. Puerto Rico: joint resolution.

(g) After the legislature has disposed of the subject(s) in the governor's call, it may be a 2/3 vote of members of both houses take up subject(s) of its own choosing in a session of up to 15 days.

(h) Regular sessions commence in December of each even-numbered year following the general election. California: the legislature continues in session until November 30 of the next even-numbered year. It may recess from time to time and may be recalled into regular session.

(i) Second session of legislature is basically limited to budget and fiscal matters. Exceptions: Colorado—items on governor's call; Maine—legislation; in the governor's call, study committee legislation and initiated measures; New Mexico—legislature may consider bills vetoed by the governor at the preceding session; Utah—legislature may consider non-budget matters after 2/3 vote of each house.

(j) Odd years: not later than first Wednesday after first Monday in June; even years: not later than first Wednesday after first Monday in May.

(k) The legislature meets in two annual sessions, each adjourning sine die. Bills carry over from first to second session. Delaware, Illinois, Virgin Island: legislature adjourns sine die and of second year only; Puerto Rico: four annual sessions.

(l) Limited to 70 days if called by governor and 30 days if called at petition of legislature, except for impeachment proceedings.

(m) Indirect restrictions only since legislator's pay, per diem, or daily allowance stops, but session may continue. Iowa: limit on per diem expenses, 120 days first session, 100 days second session. Nevada: limit on pay only. New Hampshire: constitutional limit on expenses of 90 days or July 1, whichever occurs first, 15 days salary and expenses for special session. Tennessee: constitutional limit on per diem and travel allowance only, excluding organizational session.

(n) Governor must extend until the general appropriation is passed.

(o) The legislature may divide and in practice has divided the session to meet is even years also.

(p) The first session of a new legislature. Every other even year of the gubernational item is limited to 125 C days; odd years 90 C days.

(q) If the first day falls on a legal holiday: Montana—following Wednesday; North Dakota—or falls on January 2, a date to be selected by the Legislative Council between Jan. 2 and Jan. 11; Ohio—the day after.

(r) Following each gubernatorial election, the legislature convenes on the second Wednesday of January to organize but recesses until the second Wednesday in February for the start of the 60-day session.

(s) According to a 1955 attorney general's opinion, when the legislature has petitioned to the governor to be called into session, it may then act on any matter.

(t) The legislature by joint resolution establishes the session schedule of activity for the remainder of the biennium at the beginning of the odd-numbered year. These dates may be subject to change.

(u) The legislature meets on the first Monday of each month following its initial session in January.

NATIONAL OIL JOBBERS COUNCIL,
Washington, D.C., September 22, 1983.

Hon. DAN ROSTENKOWSKI,
Chairman, House Ways and Means Committee,
Washington, D.C.

DEAR MR. CHAIRMAN: The National Oil Jobbers Council (NOJC) is a federation of 42 state and regional associations representing 12,000 independent small business marketers of motor and heating fuels. NOJC estimates that these 12,000 marketers sell nearly 50 percent of the gasoline and approximately 60 percent of the diesel fuel used by American motorists and commercial and agricultural concerns.

As the Ways and Means Committee begins its consideration of HR 3805, the Technical Corrections Bill, NOJC would respectfully urge the Committee's consideration of the following amendments to the bill:

Extend the twice monthly tax remittance schedule for diesel fuel: The Surface Transportation Act of 1982 extended the twice a month tax remittance schedule by five days on the payment of the federal gasoline excise tax. For marketers who remit the gasoline tax and who also retail diesel fuel through truck stops or their directly operated service stations, this change has meant that they now must remit taxes on the two fuels at four separate times each month. This is an unnecessary paperwork burden on small marketers. By extending the remittance schedule for diesel fuel to match the gasoline tax payment schedule Congress would alleviate and simplify the bookkeeping snarl that was inadvertantly created for marketers.

Eliminate the words "wire transfer" from PL97-424. When the Surface Transportation Assistance Act of 1982 was under discussion, language was included to require marketers to remit the gasoline tax by "wire transfer." In point of fact, the words only caused confusion within the petroleum and banking community because an adequate "wire transfer" system was already in place.

Allow retail dealer consent for marketer tax collections. Under present law jobbers can collect the diesel fuel excise tax for remittance to the federal Treasury from end-user (bulk commercial) accounts. In some situations a retail dealer would also prefer to have their jobber-supplier collect and remit the diesel tax in the same way that the gasoline excise tax is handled. Such a system is less burdensome to the small dealer who consents to such an arrangement. This system should also create fewer administrative problems for the IRS.

Allow marketers to write off bad debt excise tax payments. Jobbers more often are facing situations where one of the dealers they supply goes out of business. In those cases, they are currently required to pay the excise tax liens of that station before being permitted to reopen it. An amendment should be adopted which would permit the jobber to write off these tax liens as bad debts on their income tax payments to the IRS.

Clarify the tax liability of alternative motor fuels. At present, some motor fuels, such as compressed natural gas and propane may not be clearly covered as taxable motor fuels when used in on-the-road vehicles. An amendment should specify that these fuels are subject to the same tax liability as gasoline.

In addition, NOJC is aware that Congress may again address the truck use tax issue. Our members strongly support a lowering of these taxes and recognize that this may result in an increase in the diesel fuel taxes. We vigorously oppose, however, a two-tier tax system which establishes one tax for autos and a higher tax for over the road trucks. This system would create an administrative and technical nightmare for the marketers who sell the fuel and collect the tax. Few marketers can afford to dedicate separate pumps to fuel the two types of vehicles. Such a system is also inefficient and a waste of resources. A better solution is to charge one higher tax for all vehicles and estabilsh a refund procedure for qualified cars or lighter trucks. Such a system would also eliminate potential tax avoidance schemes and avoid the need for marketers to become "enforcers" of the tax law at the pump.

NOJC appreciate the opportunity to comment on these issues and respectfully urges the Committee's consideration of these amendments. If you or any of your staff has any questions on our submission, please feel free to call.

Respectfully submitted,

PHILIP R. CHISHOLM,
Executive Vice President.

STATEMENT OF PHILIP P. FRIEDLANDER, JR., EXECUTIVE VICE PRESIDENT, NATIONAL TIRE DEALERS AND RETREADERS ASSOCIATION

My name is Philip P. Friedlander, Jr., Executive Vice President of the National Tire Dealers and Retreaders Association ("NTDRA"), a national nonprofit trade association representing approximately 5,000 independent tire dealers and retreaders located in 50 states who are engaged in the wholesale and retail distribution of automobile and truck tires, the retreading of tires and the sale of related products and services.

Mr. Chairman, we submit to you today the following comments in support of Section 303(a), Title III, of H.R. 3805, relating to floor stock refunds on tires, and to urge the committee to address related problems tire dealers and retreaders will have with the tire and tread rubber excise tax floor stocks provisions in the Act. As you know, the Highway Revenue Act legislation was proposed and enacted within a short period of time. In certain aspects, the legislation is incomplete. We believe that the concerns set forth in the testimony are within the purpose and intent of the Act.

The Highway Revenue Act of 1982 made significant changes in the tire and tread rubber excise tax rate. The Act contained floor stock provisions in order to minimize disruption on the tire market and efffectively tax all tires sold after the effective date, January 1, 1984, at the new rates.

Temporary Regulations have been issued on floor stock refund procedures. At this point there are no regulations as to the floor stock tax on tax increased items, nor does the statute include procedures for these items.

Thus the floor stock provisions are at this point incomplete. In fact, the refund regulations ignore the fact that most dealers will have both refund and tax increased items in stock on the effective date. If the tax is imposed in a manner consistent with prior excise tax increases, the dealer will bear an unintended financial burden.

NTDRA applauds Mr. Rostenkowski for introducing H.R. 3805, and urges the Committee on Ways and Means to address the following concerns: (1) allow a floor stocks refund on tax reduced items; (2) stipulate that the due date of the taxes be no earlier than October 1, 1984; (3) allow a floor stocks refund on retread tires; and (4) require manufacturers to process floor stock refund claims on behalf of dealers who submit them to the manufacturers on a timely basis. Each of these issues is discussed in detail below.

1. Allow a floor stocks refund on tax reduced articles.

As noted, NTDRA supports Section 303(a), Title III of H.R. 3805 allowing for floor stocks refunds for tires taxed at a lower rate after January 1, 1984.

This statutory change is necessary to avoid the disruptive effect that the change in the excise tax rates on tires will have on the industry. Floor stocks provisions were provided, but were incomplete. In addition, this resolution will treat tax reduced articles on a consistent basis with both tax repealed and tax increased articles under Sections 521 and 522 of the 1982 Highway Revenue Act.

The Act amended Section 4071(a) of the Internal Revenue Code providing a new schedule for the imposition of excise tax on the sale of tires by the manufacturer, producer, or importer. Under the new tax rate schedule, the tax on certain tires increased while the tax on other tires was reduced or repealed.

The new tax rates with respect to tires are to become effective January 1, 1984. As in prior excise tax changes, Congress realized such tax adjustments would produce disruptive market conditions.

Therefore, to reduce the effect of the tax adjustment on the tire market, Congress enacted Sections 521 and 522 of the Act. The intent of these sections was to equalize the tax burden on all tires sold after the effective date by subjecting floor stocks to the new tax rates. For example, a dealer who has a 100 pound tire in inventory on January 1, 1984 will be liable to pay $5.75, the difference increase because of the change of rates.

Unfortunately, these sections of the Act omitted consideration of a significant category of articles and therefore as presently structured are inconsistent and will fail to eliminate unnatural market conditions. Section 521 of the Act imposes a tax in the amount of any increase in the tax on floor stock items, whereas Section 522 allows a refund or credit on the total tax on any floor stock item that is no longer subject to excise tax under the new rate schedule. Neither section provides for a refund or credit with regard to floor stock items on which taxes will be reduced but not totally eliminated.

It was never intended that the dealer should bear the burden of excise taxes on tires. This tax cost should be passed on to consumers. However, due to the competi-

tive nature of the tire market, dealers will not be able to pass on the higher tax paid since these floor stock items must compete against tires delivered in 1984 with tax paid at the new lower rate.

H.R. 3805 provides for a refund on such tax reduced items. By neutralizing the effects of all tax changes on inventories, the implementation of the new excise tax rate schedule on tires may be accomplished with a minimal effect on the industry's market. Industry sources indicate a revenue loss to the Highway Trust Fund of approximately $8 million. This resolution will place tax increases and decreases on floor stock articles on a consistent basis.

2. Stipulate that the due date of the taxes be no earlier than October 1, 1984.

The Act restructured various excise taxes dedicated to the Highway Trust Fund (the "Fund"). The purpose of such changes was to shift the excise tax burden to the highway travelers responsible for the damage to our highway system. In doing so, the Act amended Section 4071(a) of the Internal Revenue Code to change excise tax rates imposed on tire and tread rubber products. These changes included decrease or repeal of the rate on some items and increase of the rate on others. Congress realized that such adjustments could adversely affect the tire market and industry and therefore enacted the floor stocks provisions under Sections 521-523 of the Act.

These sections of the Act subject dealers' floor stocks of tires and tread rubber to the new excise tax rates as of January 1, 1984, the effective date of the rate changes. The purpose is to assure the implementation of such rate adjustments with the least disruption to the industry's market.

However, unless the burden that such provisions will place on the dealers is relieved or substantially reduced, the market will be adversely affected. This disruption of normal market conditions will not only impose an additional burden on tire dealers, but may affect the consuming public as well.

Section 521(d) of the Act specifies that the due date for payment of tax increases on floor stock tires shall be at such time after February 15, 1984 as the Secretary may prescribe. To avoid an inequitable financial burden on tire dealers, that date should be no earlier than October 1, 1984.

Under the Act, refund claims on tax repealed floor stocks items will be processed through the manufacturers. It will be the manufacturers, not the dealers, who will actually file a refund claim with the IRS. Thus, the dealer must look to the manufacturer for timely receipt of any refund. The refund procedures of the Act and temporary regulations thereunder provide no requirements for manufacturers to process such refunds on a timely basis, nor to credit or make refunds to dealers before October 1, 1984. Indeed, if the consent form approach is used refunds to the dealer could be delayed even longer.

Dealers, on the other hand, will be required to pay to IRS the total increased tax on their floor stocks regardless of the status of any refunds due them from manufacturers. This tax will be due on a date to be specified in regulations implementing Section 521 of the Act. Therefore, the dealers will be forced to finance a tax burden substantially in excess of their actual floor stocks tax liability intended by Congress, for any period by which the tax due date precedes the date on which dealers are refunded.

Every day of that period places an undue stress on the working capital position of dealers. For example, one member recently estimated that he will be subject to floor stocks tax of $80,000. The member also estimates he will be eligible for $120,000 in refunds. However, to force such a dealer to finance the $80,000 from his own working capital or, more likely through a loan, is clearly inequitable. The tire dealers do not expect nor will they receive any interest on their refunds. Therefore, they should not be forced to incur such financing charges on tax liabilities. Such an inequitable situation would substantially defeat the purpose of the floor stock adjustments. The floor stocks provisions in the law are intended to minimize rather than impose additional burdens on the affected industry. The dealer is a middleman in the collection process of any excise tax that is paid by the manufacturer but intended to be eventually borne by the consumer. The intention of the Act was to place the burden of these excise taxes on individuals responsible for the wear and tear on our highway system. There was no intention that the dealers should bear such a burden.

Establishment of the due date at approximately the time when refunds are to be received would make the tax burden on dealers much more equitable.

The excise tax on tires and tread rubber is segregated from the general tax revenues of the Treasury and dedicated to the Highway Trust Fund. The Act (Section 522(d)) specifically provides that floor stocks refunds shall be paid ultimately from the Fund, not from general tax revenues. The Fund is presently in a surplus financial position. The payment of floor stock refunds prior to collection of floor pay-

ments would not jeopardize the Fund's financial stability. Therefore, a delayed payment date for the additional floor stock taxes will not subject the Fund to any financial burden but will relieve the dealers of a significant burden.

The intent of the restructuring of the excise tax rates was to place the burden of increased taxes on highway users. Dealers are mere conduits of this tax and should not be inequitably burdened by it.

It may be argued that the dealers' tax liability on tax increased articles will be recouped from consumers when such articles are sold.

Assuming, however, that such costs may be passed on, the dealers will still be subject to substantial delays in recovering such additional costs. A study conducted by NTDRA in 1982, revealed that the average industry inventory turnover for the products affected is 143–148 days. In addition, it may take up to 30 days for sales on credit (credit cards, etc.) to be collected in cash. Therefore, even if dealers are able to recoup the additional taxes by passing them on to consumers, they would not do so for approximately 180 days.

The floor stocks tax provision of the Act could impose a substantial financial burden on dealers. The industry has been heavily impacted by the recession. The burden imposed on working capital position of many members, both large and small, deserves serious attention.

Therefore, we request that the due date under Section 521(d)(2) of the Act be no earlier than October 1, 1984.

3. Allow a floor stocks refund on retread tires.

Legislative change is necessary to avoid an unintended and unequitable tax burden otherwise imposed upon tire dealers who sell retread tires, and to place domestic retread tires on an equal competitive basis with imported retread tires. The resolution will treat the tread rubber on retread tires as a tax repealed article under Sections 521 and 522 of the 1982 Highway Revenue Act.

The Act amended Section 4071 (a) of the Internal Revenue Code to provide a new schedule for the imposition of excise tax on the sale of tires by the manufacturer, producer, or importer. Under the new tax rate schedule, the tax on retread rubber was repealed. However, the Internal Revenue Service does not interpret "retread rubber" to include such rubber already placed on tires. Therefore tires retreaded prior to January 1, 1984 will include an additional cost equal to the excise tax paid on the retread rubber.

This situation may place an unequitable tax burden on the dealers. The excise taxes were not intended to be borne by the dealers. However, due to the competitive nature of the tire market, dealers with tires retreaded prior to January 1, 1984, will not be able to pass on the tax while competing with dealers selling tires retreaded after December 31, 1983 and thus not subject to the excise tax.

Certain imported retreaded tires would be eligible for refunds of the excise tax paid on the retread rubber. Such tires are exported to a foreign country for retreading and then imported to the United States for sale. Under Section 4071 (f) of the Internal Revenue Code the importation of such tires is treated as the importation of the underlying retread rubber. Therefore such tires would be eligible for a floor stock refund of all the excise tax paid thereon. As a result, the United States retread tires would be placed at a competitive disadvantage to such imported retread tires.

NTDRA requests legislation providing for a refund on the floor stock of retread tires held by dealers on January 1, 1984. Such a refund will provide consistent treatment for tread rubber whether or not it has been attached to a tire as of January 1, 1984. In addition, a floor stock refund on retread tires would place United States retread tires on equal competitive position with respect to certain foreign retread tires.

4. Require manufacturers to process floor stock refund claims on behalf of dealers who submit them to manufacturers on a timely basis.

The Highway Revenue Act of 1982 amended Section 4071 (a) of the Internal Revenue Code providing a new schedule of excise tax rates on tires and tread rubber as of January 1, 1984. Floor stocks provisions were provided, but were incomplete. These provisions permit a refund of excise taxes paid on inventory articles that are no longer subject to excise tax under Section 4071 (a).

Floor stocks provisions, in general, implement tax rate changes on tire and tread rubber products in an equitable manner. The procedures provided in the statute, however, provide no assurance that the dealer will actually receive refunds. On the other hand, dealers will be directly liable for any floor stock tax due on items on which the tax rate is increased.

The intent of the Act is that each dealer receive a refund of tax paid on his floor stocks of those tires which will thereafter be subject to tax at the new lower rate.

The excise tax, paid by the dealer on floor stock items, will not be recoverable otherwise, since these items will be competing against tires delivered after January 1, 1984 and therefore subject to tax at the new lower rate.

The Act provides that the manufacturer, producer or importer, rather than the dealer, shall file a claim for and receive the refund from Treasury. There is, however, no requirement for manufacturers, producers and importers to process these requests on behalf of their dealers.

We believe that domestic manufacturers will, in fact, process refund claims on behalf of their dealers. It makes good business sense to do so. On the other hand, there has already been at least one indication that some importers do not see it this way.

The small independent tire dealer would bear a tax burden not intended by the excise tax restructuring if the manufacturer, producer or importer chooses not to process the refund claims. Legislation is needed to remedy this inequitable situation.

CONCLUSION

NTDRA applauds the committee's attempts to correct technical aspects of the Highway Revenue Act of 1982. Certainly the concerns we have brought to the committee's attention—allowing a floor stocks refund on tax reduced items, stipulating that the due date on taxes be no earlier than October 1, 1984, allowing a floor stocks refund on retread tires, and requiring manufacturers to process floor stock refund claims on behalf of dealers who submit them to the manufacturers on a timely basis—would correct a pending financial burden on tire dealers and retreaders not intended by the Act.

NTDRA has filed a petition with the Honorable John C. Chapoton, Assistant Secretary for Tax Policy, Department of the Treasury, requesting that the Agency address through regulation the concerns we have spelled out. Thus far Treasury has neither responded to our petition nor issued final regulations.

We therefore pledge our support to H.R. 3805 and urge the committee to initiate legislative amendments or addendums to respond to and to correct all of the technical deficiencies in the Highway Revenue Act of 1982 which will inadvertently cause economic burdens on tire dealers and retreaders.

THE PERMANENTE MEDICAL GROUP, INC.,
Oakland, Calif., September 28, 1983.

JOHN J. SALMON,
Committee on Ways and Means,
Washington, D.C.

DEAR MR. SALMON: This letter is a statement for the record of the Committee's proceedings on H.R. 3805, the Technical Corrections Act of 1983. This comment is submitted on behalf of The Permanente Medical Group, Inc. ("Permanente") which we believe is the largest professional corporation in the United States, and which provides medical services in Northern California to members of Kaiser Foundation Health Plan.

Permanente strongly supports section 103(f)(1)(C) of H.R. 3805 which would amend section 416(i)(1)(A) of the Internal Revenue Code which defines "key employees" under the top-heavy rules. This amendment would clarify the definition of the ten top employees of a company so that no more than ten people would be included in this category. This would correct the result under the proposed Treasury regulations, which provide that over 1,400 shareholder-employees of Permanente could be included as "top ten" employees (and thus key employees) under the top-heavy rules, for all shareholders of Permanente are equal shareholders. Although this comment is submitted on behalf of Permanente, other medical groups, which provide services to members of Health Plan in other regions, have the same problem.

DISCUSSION

Permanente is a professional corporation that provides medical services in Northern California to over 1,800,000 members of Kaiser Foundation Health Plan. Permanente has over 10,400 employees including over 7,300 union employees and over 2,000 physicians. Of the physician employees, 1,426 are shareholders. Each shareholder owns exactly the same number of shares.

The Treasury's proposed regulations under section 416 define "key employee" under section 416(i)(1)(A) and take the position that the "top ten owners" category

includes every employee with some ownership interest in the employer, unless ten other employees own a greater interest. The example provided by the proposed regulations shows that there is no limit to the number of employees who are to be regarded as among the top ten owners when the ownership interests are equal. Prop. Reg. 1.416-1, Q & A T-12. As applied to Permanente, under these regulations the definition of the ten top employees could include all 1,426 physician employee-shareholders.

We believe that this regulation is not authorized by the statute and should be revised. The proposed regulation appears to be based on a parenthetical phrase in the TEFRA Conference Report which notes, in connection with the definition of the top ten employees, that "(there are not ten employees owning greater interests than the employee)." H. Rept. No. 97-760, p. 626. The parenthetical goes well beyond the statute; this seems clear from the "General Explanation of TEFRA" published by the Joint Committee on Taxation; here, the parenthetical is conspicuously absent. Jt. Tax Comm., General Explanation of TEFRA, p. 316. Nevertheless, to ensure the correct application of TEFRA, section 103(f)(1)(C) of H.R. 3805 should be enacted.

Obviously, the rule in the proposed regulation could be avoided if Permanente were to create a new class of ten owners, each of whom owned more stock in Permanente than any other shareholder. This type of change would disrupt a policy of equal ownership that has been followed for decades. We believe that the tax laws should not dictate the ownership structure of a business in this way, and thus we strongly support section 103(f)(1)(C) of H.R. 3805.

Very truly yours,

W. WILLIAM PETRICK.

PERKINS, COIE, STONE, OLSEN & WILLIAMS,
Seattle, Wash., September 7, 1983.

Hon. DAN ROSTENKOWSKI,
Chairman, Ways and Means Committee,
Washington, D.C.

DEAR CHAIRMAN ROSTENKOWSKI: This letter will serve as a request for inclusion in the Technical Corrections Act of 1983 of a correction to the Tax Equity and Fiscal Responsibility Act of 1982.

Section 168(f)(8)(D)(v) of the Code authorizes safe harbor leases for "qualified mass commuting vehicles". That Section refers to Section 103(b)(9) for the definition of "qualified mass commuting vehicles".

Section 217(c) of TEFRA amended Section 103(b)(9) to make it clear that ferry vessels are qualified mass commuting vehicles. The amendment was sponsored by Senator Slade Gorton of the State of Washington and the purpose of the amendment was to ensure that ferry vessels already financed, built and operating on Puget Sound adjacent to Seattle, Washington, could be the subject of a safe harbor lease under Section 168(f)(8).

One additional requirement of Section 168(f)(8)(D)(v) is that qualified mass commuting vehicles must be financed in whole or in part by obligations the interest on which is excludable under Section 103(a) of the Code. The ferry vessels of the State of Washington were wholly financed by general obligation bonds of the State, the interest on which is excludable under Section 103(a). Consequently, the only applicability Section 103(b)(9) has to a safe harbor lease of the ferries is for purposes of providing a definition of qualified mass commuting vehicles.

This law firm represents the State of Washington with respect to a safe harbor lease of the ferry vessels. In attempting to consummate a safe harbor lease transaction, we became aware that Section 217(e) of TEFRA, which established the effective date for the amendments to Section 103(b) of the Code, including the amendment regarding the definition of qualified mass commuting vehicles under Section 217(c) of TEFRA, created some ambiguity with respect to the proposed safe harbor lease transaction. Section 217(e) of TEFRA provides as follows:

"(e) The amendments made by this section shall apply to *obligations* issued after the date of the enactment of this Act."

This language made it unclear whether, for purposes of obtaining safe harbor lease treatment, the ferry vessels were required to be financed in whole or in part by obligations (industrial development bonds or otherwise) issued after September 3, 1982, the effective date of TEFRA. It may be that the draftsman intended the effective date language to apply only if industrial development financing were utilized or that he or she was simply unaware that the ferry vessels which were the subject of Senator Gorton's amendment had been financed by general obligation bonds some-

time prior to the date of the amendment. The purpose of this amendment really had nothing to do with industrial development bond obligations issued under Section 103(b).

In order to cure the effective date language of Section 217(e) of TEFRA, we suggest revising the section as follows:

"The amendments made by this section shall apply to obligations issued after the date of enactment of this Act *for purposes of Section 103 and, for purposes of Section 168(f)(8)(D)(v) (relating to safe harbor leases of qualified mass commuting vehicles), to agreements entered into after the date of enactment of this Act.*"

Two alternatives you may wish to consider for making this technical correction are:

1. Section 168(f)(8)(D)(v) of the Code could be amended to read as follows:

"The term 'qualified leased property' includes recovery property which is a qualified mass commuting vehicle (as defined in Section 103(b)(9) as in effect after the amendments made by the Tax Equity and Fiscal Responsibility Act of 1982) which is financed in whole or in part by obligations the interest on which is excludable under Section 103(a)."

The insertion of the underlined language in Section 168(f)(8)(D)(v) would eliminate the need for changing the language of the effective date under Section 217(e) of TEFRA.

2. Section 208(d)(5) of TEFRA could be amended by adding a sentence at the end to read as follows:

"For purposes of Section 168(f)(8)(D)(v) of such Code, as in effect after the amendments made by this Act, the reference to Section 103(b)(9) for the definition of a qualified mass commuting vehicle shall mean Section 103(b)(9) as in effect after the amendments made by TEFRA."

Please include whatever technical correction you deem appropriate with respect to the effective date under Section 217(e) of TEFRA in the Technical Corrections Act of 1983.

If additional information is required or would be helpful, please contact the undersigned. Also, I would appreciate it if you would keep me informed of the status of this request.

Thank you for your consideration.

Respectfully submitted,

ELIZABETH ROCKWELL BROWN.

PILLSBURY, MADISON & SUTRO,
San Francisco, Calif., September 9, 1983.

JOHN J. SALMON,
Chief Counsel, Committee on Ways and Means,
Washington, D.C.

DEAR MR. SALMON: I am writing in regard to section 201(f)(1) of H.R. 3805, the Technical Corrections Act of 1983, introduced on August 4 by Congressmen Rostenskowski and Conable. That provision would change section 1361(d)(2)(D) of the Internal Revenue Code, by striking out "60 days" and inserting in lieu thereof "75 days."

On behalf of a client, it has come to my attention that section 1361(d)(2)(D) is defective, and in need of amendment. The amendment which has been proposed, however, will not cure the defect, although it will ameliorate one aspect of it. I am writing this letter to bring the defect to your attention, and to suggest that a different and more extensive amendment is called for.

Section 1361(a)(1) of the Code defines the term "S corporation" to mean "a small business corporation for which an election under section 1362(a) is in effect."

Section 1361(b)(1) defines the term "small business corporation" to mean a domestic corporation which does not, among other things:

"(B) have as a shareholder a person (other than an estate and other than a trust described in subsection (c)(2)) who is not an individual."

Section 1361(c)(2) provides that certain types of trusts are permitted, for purposes of subsection (b)(1)(B), just quoted, to be shareholders of small business corporations. Section 1361(d)(1) provides that a "qualified subchapter S trust with respect to which a beneficiary makes an election under paragraph (2)" shall be treated as a trust described in section 1361(c)(2)(A). The term "qualified subchapter S trust" is defined in section 1361(d)(3).

The election which is required before a "qualified subchapter S trust" can be treated as a trust which is a qualifying shareholder of a small business corporation is provided for in section 1361(d)(2), in the following terms:

"(2) Election.—

"(A) In general.—A beneficiary of a qualified subchapter S trust (or his legal representative) may elect to have this subsection apply.

"(B) Manner and time of election.—

"(i) Separate election with respect to each S corporation.—An election under this paragraph shall be made separately with respect to each S corporation the stock of which is held by the trust.

"(ii) Elections with respect to successive income beneficiaries.—If there is an election under this paragraph with respect to any beneficiary, an election under this paragraph shall be treated as made by each successive beneficiary unless such beneficiary affirmatively refuses to consent to such election.

"(iii) Time, manner, and form of election.—Any election, or refusal, under this paragraph shall be made in such manner and form, and at such time, as the Secretary may prescribe.

"(C) Election irrevocable.—An election under this paragraph, once made, may be revoked only with the consent of the Secretary.

"(D) Grace period.—An election under this paragraph shall be effective up to 60 days before the date of the election."

Note that section 1361(d)(2)(B) provides for both the "Manner" and the "Time" for making the election. This is set forth in section 1361(d)(2)(B)(iii), which provides that:

"Any election, or refusal, under this paragraph shall be made in such manner and form, *and at such time*, as the Secretary may prescribe." (Emphasis added.)

It is apparent from the language just quoted that Congress intended the Secretary to have the power to prescribe by regulations for the time when the beneficiary election must be made, as well as the content of the election. With that power goes the power of the Secretary, exercising his discretion upon good cause shown, to grant reasonable extensions of the time fixed by the regulations, pursuant to Income Tax Regulations section 1.9100-1(a). Extensive provision has been made for the exercise of this discretion by the Secretary, through his appointed representative, the Commissioner of Internal Revenue, in Revenue Procedure 79-63 (C.B. 1979-2, 578).

It is submitted that section 1361(d)(2)(B)(iii) as it stands can be a trap for the unwary, in that it may not mean what it plainly says, if section 1361(d)(2)(D) can be read as placing an upper limit on the number of days for which a beneficiary election may have retroactive effect. The reason is that the election, however, timely it may be considered to be, cannot operate to revive a subchapter S election for a qualifying small business corporation, if the election has already been terminated because there was at least a moment of time during the taxable year when the corporation had as a shareholder a trust which did not meet the terms of section 1361(c)(2)(A). If section 1361(d)(2)(D) is interpreted in this harsh manner, it operates as a cap, or upper limit, on the degree to which an otherwise timely beneficiary election may operate retroactively, and therefore, as the true deadline for making the election. While that interpretation would make a nullity of much of the language of section 1361(d)(2)(B)(iii), it is an interpretation which the Service may feel itself constrained to adopt. An amendment to negate the possibility that such an interpretation will be given section 1361(d)(2)(D) would qualify, in my judgment, as a "technical correction."

It is believed that the genesis of section 201(f)(1) of the Technical Corrections Act of 1983 was the recognition that a corporation which already had as a shareholder a trust otherwise meeting the definition of a "qualified subchapter S trust" might reasonably believe that it had, pursuant to section 1362(b)(2)(A), as long as the 15th day of the third month after the beginning of its taxable year in which to make a timely subchapter S election. In view of the grace period restriction in section 1361(d)(2)(D), however, any such subchapter S election filed after the 60th day of the taxable year could be a nullity, because of the presence of the trust as a shareholder, and because the grace period provision may be considered to carry backward in time only 60 days, and thus to permit a moment of time during that taxable year in which the corporation has a nonqualifying shareholder. See "How to Coordinate the QSST and S Corporation Elections," 58 J. Tax 280 (May 1983). While the change in section 201(f)(1) of the Technical Corrections Act from "60 days" to "75 days" would remove that possibility, it would leave behind the apparent contradiction in section 1361(d)(2) between the intent Congress had in assigning to the Secretary the power, by regulations, to determine the time when a beneficiary election shall be filed, and what some may interpret as the maximum degree, expressed in section 1361(d)(2)(D), to which such an election, however timely, may be given retroactive effect.

It is submitted that the degree to which a beneficiary election should be given retroactive effect ought to go hand in hand with the deadline for filing the election. While that deadline ought to be soon enough after the trust becomes the shareholder that there will be little opportunity for second guessing, or other prejudice to the Government, the type of determination to be made—whether there has been any such prejudice—is one which the Commissioner is well equipped to handle, in the exercise of his discretion under Income Tax Regulations section 1.9100(a). Thus, the amendment to section 1361(d)(2)(D) which would most closely accord with Congress' apparent true intent would be to provide that an election under the paragraph shall be effective from the date the trust becomes a shareholder, provided only that the election is timely made.

An analogy to the situation presented by section 1361(d)(2) may be found in section 508(a) of the Code. Section 508(a)(1) provides, in effect, that an organization shall not be treated as qualifying under section 501(c)(3) from the date of its formation, unless it gives timely notice to the Secretary that it is applying for recognition of such status. Section 508(a)(2) then provides that an organization shall not be treated as described in section 501(c)(3):

"(2) for any period before the giving of such notice, if such notice is given *after* the time prescribed by the Secretary by regulations for giving notice under this subsection" (emphasis added).

Under these provisions, the Commissioner has determined that he has the power, pursuant to Income Tax Regulations section 1.9100, to grant extensions of the time to file the notice provided for in section 508(a)(1). Revenue Ruling 80-259 (C.B. 1980-2, 192); Revenue Ruling 81-177 (C.B. 1981-2, 132). The Commissioner has also ruled that, having exercised his discretion under the section 1.9100 regulations to extend the time for filing the notice, a notice filed within the extended time operates retroactively to the date of formation of the organization in question. In other words, the degree to which the notice operates with retroactive effect is controlled by the same discretion of the Commissioner which controls the filing of a timely notice. L.R. 8042151 (July 28, 1980).

Another example of a similar relationship between the deadline for filing a notice, and the retroactive effect of the notice once filed, may be found in sections 120(c) and (d) of the Code (see L.R. 8228037) (April 13, 1982) and L.R. 8141056 (July 16, 1981)).

I have been able to find no legislative history revealing why Congress originally specified 60 days as the "grace period" for section 1362(d)(2) elections. The whole provision is carried over almost verbatim from section 1371(g)(2) of the Code as added by section 234(b) of the Economic Recovery Tax Act (P.L. 97-34), and prior to its amendment by the Subchapter S Revision Act of 1982 (P.L. 97-354).

Section 234(b)(2)(F) of the House version of ERTA simply provided that an election would be made by certain trusts in the time and manner prescribed by the Secretary.

The Senate added the provisions of section 1371(g) as eventually adopted. The Finance Committee Report, in describing the grace period provision, stated that "an election *may be* made retroactive for a period of up to 60 days" (S. Rept. No. 97-144, P. 91, emphasis added). I suspect that the idea for using 60 days came simply from the fact that certain other types of trusts permitted as temporary subchapter S shareholders could continue as such only for a 60-day period (e.g., § 1371(e)(1)(B) and (C)). While I have no quarel with a statutory upper limit of 60 days for certain trusts to continue as shareholders, it seems unlikely Congress intended such a rigid time period for filing an election for a type of trust which expects to be a qualifying shareholder for years and years thereafter.

I therefore recommend that, in lieu of the amendment provided for in section 201(f)(1) of the Technical Corrections Act, section 1361(d)(2)(D) be amended to read as follows:

"(D) Grace period.—An election filed within the time prescribed by the Secretary under this paragraph shall be effective from the date the trust first became a shareholder of the S corporation."

As previously indicated, the defect in section 1361(d)(2)(D) was carried over from prior law, in section 1371(g)(2)(D). The difficulty under prior law was compounded because the Treasury published temporary regulations setting forth the manner of making the election under section 1371(g)(2), but in such regulations, inadvertently failed to state the deadline for making such an election (Temp. Regs., § 5c.0(d), issued October 29, 1981). It is my understanding that the Commissioner believes he has the power, under these temporary regulations, to allow late elections under section 1371(g)(2) of prior law, provided there is no prejudice to the Government, but believes there may be difficulty granting retroactive effect to such a late election,

because of the language of section 1371(g)(2)(D). There are apparently taxpayers who inadvertently failed to file timely elections under former section 1371(g)(2)(D) and who the Commissioner may feel he is without power to relieve from their failure, despite a finding of reasonable cause, because of the rigidity of section 1371(g)(2)(D). Thus, it would be appropriate, if section 1361(d)(2)(D) is to be amended in the manner suggested, to make a corresponding amendment at the same time to section 1371(g)(2)(D) of prior law, as added by the Economic Recovery Tax Act of 1981. This corresponding amendment, as a technical correction, would take effect as if included in section 234(b) of the Economic Recovery Tax Act of 1981.

It is submitted that the amendments suggested above are consistent with the liberal attitude toward inadvertant terminations, and other obstacles to continued effectiveness of a subchapter S election, which was expressed by Congress in section 1362(f), as added by the Subchapter S Revision Act of 1982. The Senate Finance Committee report accompanying that provision described it as follows:

"The committee intends that the Internal Revenue Service be reasonable in granting waivers, so that corporations whose subchapter S eligibility requirements have been inadvertently violated do not suffer the tax consequences of a termination if no tax avoidance would result from the continued subchapter S treatment. * * * It is expected that the waiver may be made retroactive for all years, or retroactive for the period in which the corporation again became eligible for Subchapter S treatment, depending on the facts." (S. Rept. No. 97-640, 12-13).

Please let me know if there is anything further I can provide which will assist you in considering this matter.

Very truly yours,

STEPHEN J. MARTIN.

SHEA & GOULD,
Washington, D.C., September 27, 1983.

Hon. DAN ROSTENKOWSKI,
Chairman, Ways and Means Committee,
Washington, D.C.

DEAR MR. CHAIRMAN: Thank you for this opportunity to be heard and I request that my remarks be made part of the written record of these Hearings.

I wish to address myself to a matter that has arisen as a result of TEFRA and I believe can properly be included in the Technical Correction Bill (H.R. 3805) currently pending before the Committee.

As part of the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA") Congress expanded the scope of Section 189 of the Internal Revenue Code to require corporations to capitalize construction period interest and taxes for nonresidential property. In extending Section 189 to corporations, however, Congress took steps to ensure that the legislation did not have retroactive effect on certain construction projects planned in writing prior to Congressional consideration of the expansion. Those projects, because of their size, complexity or nature, required a lengthy planning and governmental approval process before construction could be actually commenced.

Thus, the extension of Section 189 was generally applicable to construction of nonresidential real property begun after December 31, 1982, but a specific exception was made for the construction of hotels, motels, hospitals, and nursing homes. The exception provided that if construction of those types of projects was commenced on or before December 31, 1983, pursuant to a written plan of the taxpayer in existence on July 1, 1982, and if the taxpayer had requested, in writing, approval from a governmental unit for such construction, then those projects would be protected against the retroactive treatment under the expanded version of Section 189. The expectation of all parties concerned was that the various federal, state and local regulatory processes would be completed in time to permit construction to commence by December 31, 1983. It is, and remains, in the economic interest of the taxpayers to begin construction of those projects as soon as possible because of the substantial likelihood of increased construction costs which would result from delay.

It has now become apparent that the various regulatory processes for these specialized projects have become more time-consuming than originally anticipated. For example, approximately one-half of the hospital construction projects originally expected to be covered by the foregoing exception are not presently in a posture for commencement of construction. These projects, for which written plans were in existence prior to July 1, 1982, require federally-mandated "Certificate Of Need" approvals. Requests for such approvals for those projects are still pending in the state

and local approval process as of September 1983. The great majority of these projects are unlikely to receive final approval in time to initiate construction by December 31, 1983. In all of these cases, however, the hospital project was committed to and planned prior to July 1, 1982, when Congress began considering the extension of Section 189 to corporations. In each instance, commencement of conctruction is being delayed solely as a result of the regulatory approval process.

Similarly, as many as one-third of the hotel projects originally expected to qualify under the exception are currently precluded from commencement of construction due to prolonged state and local governmental regulatory approval processes. It is not anticipated in most of these cases that final approval will occur in time to permit commencement of construction by December 31, 1983.

I propose that the required construction start date of January 1, 1984 contained in Section 207(e)(2)(B) of TEFRA, be amended to January 1, 1985.

Finally I would point out that this amendment does not in any way expand the application of this section and hence there is no adverse revenue impact. This technicial change simply effectuates the intent of Congress last year not to apply the changes in Section 189 to projects already "in the pipeline" on July 1, 1982. My proposed amendment would not expand the Section 189 exceptions to any projects which did not otherwise meet the requirements imposed by TEFRA.

Thank you for this opportunity to be heared and be made part of the record of these hearings.

With kind regards and best wishes, I am,

Sincerely yours,

WILBUR D. MILLS.

GROOM & NORDBERG,
Washington, D.C., September 28, 1983.

Hon. DAN ROSTENKOWSKI,
Chairman, Committee on Ways and Means,
Washington, D.C.

DEAR MR. CHAIRMAN: On behalf of the Western Conference of Teamsters Pension Trust Fund (the "WCT Plan"), we respectfully submit this statement for consideration by the Committee on Ways and Means in connection with the above hearing and for inclusion in the printed record of that hearing. The WCT Plan is the largest multiemployer pension plan in the United States. At present, the WCT Plan receives contributions on behalf of more than 400,000 employees working under Teamster collective bargaining agreements with over 14,000 employers in thirteen Western states, and pays retirement benefits to over 100,000 persons. The WCT Plan is administered by 28 trustees jointly representing management and lobor pursuant to to Labor-Management Relations Act, 1947.

We strongly support section 103(g)(2) of H.R. 3805, relating to the payment of child survivor benefits under tax-qualified plans, and offer several technical suggestions to further the intent of that provision.

BACKGROUND

Section 103(g)(2) would correct a serious and unintended result of the Tax Equity and Fiscal Responsibility Act of 1982 ("TDEFRA"). That Act amended the restrictions on distributions in section 401(a)(9) of the Internal Revenue Code. These new rules have the effect, beginning generally in 1984, of preventing plans from paying benefits to the surviving minor and disabled children of a deceased participant for more than five years after the participant's death.

Section 103(g)(2) of H.R. 3805 would provide an exception to the new distribution rules for payments to minor and disabled dependents of deceased participants., The WCT Plan currently pays surivor benfits to more than 2,000 children of deceased participants, including approximately 120 disabled children who are 18 or over. These benefits generally provide extremely important financial support for these children.

We see no reason why any restrictions should be imposed on payments to minor and disabled children. If the purpose of the new distribution requirements is to prevent participants from accumulating large amounts under a plan and distributing those monies free of tax to their beneficiaries, this same purpose has already been achieved, in a much more efficient manner, by TEFRA's new limit on the estate tax exclusion for interests in qualified plans. If the purpose is to increase tax revenues, precluding long-term payments to surviving children is an extreme means to achieve a truley insignificant revenue gain, if any. Finally, if the purpose of the new

restrictions is to prevent manipulation of plan provisions in favor of certain key employees, that purpose is in no way served by eliminating long-term benefits to minor and disabled children. On the contrary, we believe that these benefits provide the greatest comfort, and therefore have the greatest value, to lower-paid employees. These persons are more likely to have insufficient resources to provide for their children in the event of untimely death. We therefore strongly support the amendment to permit long-term payments to minor and disabled children.

Technical suggestions

We offer the following technical suggestions relating to the precise language of section 103(g)(2) of the bill. First, the exception to the distribution restrictions would apply only if the "entire interest" of the employee, or the "remaining part of such interest," is paid to a minor or disabled dependent. Such references might be interpreted to prevent a plan from paying child survivor benefits in reliance on this provision where other payments are being made (at the same time or at different times) to the surviving spouse of the deceased participant. Under the WCT Plan, child survivor benefits may be payable to the children of participants who were not yet vested at the time of death, and ancillary survivor benefits are also payable to spouses of vested deceased participants. In addition, the WCT Plan provides for early survivor annuity benefits in accordance with the provisions of section 401(a)(11) of the Code. In our view, there is no reason why plans should be precluded from providing for survivor benefits to spouses (in accordance with section 401(a)(9)(B)) and from providing for survivor benefits to children (in accordance with the provisions of the bill). Accordingly, we request that section 103(g)(2) be revised to make it clear that child benefits and spouse benefits are to be treated separately for purposes of section 401(a)(9).

Second, the exception as presently worded requires that the benefits to the minor or disabled dependent commence not later than one year after the employee's death or the death of the surviving spouse. Child survivor benefits under the WCT Plan are generally effective beginning the month after the participant's death (unless the child is unborn at that time). However, for a variety of reasons, benefits may not actually begin to be physically paid until more than one year after the participant's death. For example, the Plan requires that the child be eligible for Social Security benefits as a result of the participant's death. A letter to this effect must be obtained from the Social Security Administration, and delays occasionally arise in unusual situations, such as if the child is not the natural child of the participant. Delays may also result because of difficulties in determining the proper person to receive the benefits on behalf of the child. Of course, if there is any delay, the first payment includes benefits retroactive to the effective date.

In our view, the one-year requirement does not seem to be needed to prevent undue tax deferral since the bill would not permit distributions to continue beyond age 22 (except in the case of disability). However, if it is desired to retain the one-year requirement, that requirement should be revised to make it clear that the exception applies if the effective date of the benefits is within one year following the participant's death.

Our final technical comment relates to the definition of "qualified dependent." In some cases, it may be difficult to establish that a minor is a dependent of the deceased participant. Accordingly, we believe that plans should be permitted to rely absolutely on a determination by the Social Security Administration that an individual qualifies for dependent benefits under the Social Security Act. Plans should not be required in these situations, during what is likely to be a period of grief and mourning, to further intrude by demanding statements or copies of tax returns to independently verify dependent status.

We sincerely appreciate this opportunity to comment. Please contact Douglas W. Ell of this office or the undersigned if you have any questions on this subject.

Respectfully submitted,

LOUIS T. MAZAWEY,
Attorney for the Western Conference of Teamsters Pension Trust Fund.

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